Jurisdictional Statement

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No. . . .

IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS and LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

REGINALD D. DE LA CUESTA, *et al.*,
Appellees.

FIDELITY FEDERAL SAVINGS and LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

ALPHONSO MOORE, *et al.*,
Appellees.

FIDELITY FEDERAL SAVINGS and LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

JOHN D. WHITCOMBE,
Appellee.

**On Appeal from the California Court of Appeal,
Fourth Appellant District.**

JURISDICTIONAL STATEMENT

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Questions Presented.

The Federal Home Loan Bank Board, an agency of the United States, pursuant to Section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. § 1464), adopted regulations (12 C.F.R. § 545.8-3) reaffirming the authority of federal savings and loan associations, which it charters and regulates, to include "due-on-sale" clauses in mortgage loan contracts permitting a loan to be called if the borrower transfers the real property security, and, in accordance with the Supremacy Clause (Art. VI, cl. 2) of the United States Constitution, proclaimed that the exercise of such "due-on-sale" clauses is to be governed only by those regulations, the application of state law being expressly preempted.

The California Court of Appeal has held that California Civil Code § 711, which prohibits unreasonable restraints on alienation as interpreted in *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978), may be validly applied to prohibit Appellant, a federal savings and loan association, from exercising, in California, the "due-on-sale" clause in mortgage loan contracts for the purpose of raising the interest rates on those contracts, irrespective of the Federal Home Loan Bank Board regulations described. The California Court held that neither the Home Owners' Loan Act of 1933 nor the Bank Board regulations preempted the application of Civil Code § 711, as construed in *Wellenkamp*, and that as to some of Appellant's mortgage loan contracts federal law was not applicable because of the inclusion of another clause which makes the contract subject to the law of the jurisdiction where the real property security is located. The California Court's decision presents the following questions:

1. Whether by virtue of the Supremacy Clause the Home Owners' Loan Act of 1933 and the Bank Board reg-

ulations promulgated thereunder, the application of Civil Code § 711, as interpreted in *Wellenkamp*, to federal savings and loan association due-on-sale practices has been preempted.

2. Whether the "law of the jurisdiction" clause in a mortgage loan contract prevents the Federal Home Loan Bank Board regulations from governing the due-on-sale practices of federal savings and loan associations.

Parties to the Proceeding.

Appellants: Fidelity Federal Savings and Loan Association ("Fidelity Federal"), a federally chartered mutual corporation and Gateway Mortgage Corporation ("Gateway"), a wholly-owned subsidiary of Fidelity Federal. The only entity required to be disclosed by Rule 28.1 of this Court is Fidelity National Trust Company, a subsidiary of Fidelity Federal.

Appellees: Reginald D. de la Cuesta, Margaret de la Cuesta, Alphonso Moore, Alice Moore, and John D. Whitcombe.

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JURISDICTIONAL STATEMENT.

OPINIONS BELOW.

The opinion of the California Court of Appeal, Fourth District, is published as *Reginald D. de la Cuesta v. Fidelity Federal Savings and Loan Association,* 121 Cal. App. 3d

328, 175 Cal. Rptr. 467 (4th Dist. 1981), and is reproduced at Appendix 1a. The Order Granting Summary Judgment and Judgment entered by the Superior Court of California for the County of Orange are reproduced at Appendix 29a and 30a, respectively.

JURISDICTION OF THIS COURT.

This is an appeal from a decision of the California Court of Appeal, Fourth District. The decision was entered by that Court on July 2, 1981 (Appendix 1a), and a timely petition for rehearing was denied on July 22, 1981 (Appendix 27a). A timely petition for hearing by the California Supreme Court was denied on August 26, 1981 (Appendix 28a). Notice of Appeal was thereafter filed with the Court of Appeal on October 14, 1981, within 90 days of the California Supreme Court's denial of hearing (Appendix 32a).[1]

This appeal is taken, and jurisdiction is conferred upon this Court, by 28 U.S.C. § 1257(2).[2]

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED.

This appeal involves the Supremacy Clause (Art. VI, cl. 2) of the United States Constitution, Section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. § 1464(a)), Federal Home Loan Bank Board Regulations 12 C.F.R.

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[1] *American Railway Express Co. v. Levee*, 263 U.S. 19, 20-21 (1923).

[2] Appellate jurisdiction of this Court in actions involving claims that state law may not be validly applied due to preemption by federal law was recognized by this Court in *La Crosse Telephone Corp. v. Wisconsin Employment Relations Board*, 336 U.S. 18, 20 (1949), and *Bethlehem Steel Co. v. New York State Labor Relations Board*, 330 U.S. 767, 768 (1947). Should this Court find that this appeal has been improvidently taken under 28 U.S.C. § 1257(2), Appellants respectfully request that this Jurisdictional Statement be considered as a Petition for Writ of Certiorari under 28 U.S.C. § 1257(3), in accordance with 28 U.S.C. § 2103. As preemption of state law raises a constitutional question, 28 U.S.C. § 2403(b) may be applicable.

§ 545.8-3(f) and (g), and 12 C.F.R. § 556.9(f), Federal Home Loan Bank Board Resolution 76-296, and California Civil Code § 711. Each of these provisions is set forth in full, or in pertinent part, commencing at Appendix 36a.

STATEMENT OF THE CASE.

The controlling facts in this consolidated case are not in dispute.[3] Appellant Fidelity Federal Savings and Loan Association ("Fidelity Federal") is a federal savings and loan association chartered and regulated by the Federal Home Loan Bank Board ("Bank Board") pursuant to Section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. § 1464(a)) ("HOLA").

Appellant Fidelity Federal makes long term loans for the purchase of real property, which loans are in turn secured by deeds of trust on the real property so purchased by the borrower. Fidelity Federal is the beneficiary under these deeds of trust while Gateway, Fidelity Federal's subsidiary is the trustee on the deeds of trust.

The Appellees are each purchasers of real property which by deed of trust, secures a loan earlier made by Fidelity Federal to the transferors of that property. In each instance the transferors sold the property without Fidelity Federal's prior written consent even though each deed of trust includes a clause which provides that if the real property is transferred without Fidelity Federal's prior written consent that Fidelity Federal may call the loan due (a "due-on-sale" clause).

As a result of the unconsented-to transfer by each Appellee Fidelity Federal exercised the due-on-sale clause in the deed of trust and accelerated the principal balance due

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[3]Three separate actions against Appellant were consolidated before entry of judgment in the trial court. Following consolidation the cases were treated as one case in the California trial and appellate courts, and are so treated here.

on the secured promissory notes. When the accelerated principal balance was not paid Fidelity Federal commenced nonjudicial foreclosures. Fidelity Federal would have consented to the transfers and not commenced foreclosure had the Appellees been willing to have the interest rates on the promissory notes increased to then prevailing market rates.

The Appellees thereupon each commenced an action in the California courts to enjoin the foreclosure and for damages. The Appellees contended in their complaints that by reason of Civil Code § 711, as construed by the California Supreme Court in *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978), the immediate and automatic exercise by Fidelity Federal of its rights under the due-on-sale clause was invalid as an unlawful restraint on alienation. That decision specifically precludes exercise of a due-on-sale clause for the purpose of increasing the interest yield on the lender's loan portfolio.

Fidelity Federal, in its answers to the complaints, as an affirmative defense, raised the principal question here presented. Fidelity Federal alleged that as a federally chartered and regulated savings and loan association Civil Code § 711 could not validly be applied to prevent its due-on-sale conduct because that section was preempted by the HOLA and the due-on-sale regulations adopted thereunder by the Bank Board.

Following consolidation of Appellees' individual actions, cross-motions for summary judgment were filed. Fidelity Federal continued to rely on its defense that Civil Code § 711, as construed in *Wellenkamp*, could not validly be applied to it due to preemption by federal law. The Appellees argued below that the federal law was not preemptive, and that in any event, by including in the deed of trust a clause which stated that the "law of the jurisdiction" where the secured real property is located would govern

only state law was applicable.[4] Fidelity Federal, in opposition, cited binding precedent of this Court, which mandates that the Supremacy Clause of the United States Constitution makes federal law a part of the law of the jurisdiction of each of the States thereby causing the Bank Board regulations to prevail.

The trial court granted Fidelity Federal's motion for summary judgment holding that Civil Code § 711 was preempted by federal law. The trial court did not expressly rule on the law of the jurisdiction issue but by necessary implication found that preemptive federal law was a part of the "law of the jurisdiction."

The Appellees appealed to the California Court of Appeal, Fourth District. Appellant Fidelity Federal, as respondent below, continued to rely on federal preemption and the precedent of this Court. The California Court of Appeal reversed the trial court's grant of summary judgment and ordered summary judgment in favor of the Appellees. The Court of Appeal held that neither the HOLA nor the Bank Board Regulations preempted Civil Code § 711. The Court of Appeal also held that the law of the jurisdiction clause made only State law applicable to the Moore and Whitcombe transactions.

Fidelity Federal sought rehearing from the California Court of Appeal as to the questions presented here, but rehearing was denied. Fidelity Federal then petitioned the California Supreme Court to grant a hearing to review the questions here presented. On August 26, 1981 the petition for hearing was denied by the California Supreme Court, without comment.

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[4]The Appellees asserted that the law of the jurisdiction clause was in the deeds of trust involved in the Moore and Whitcombe actions. The clause, in fact, is only in the deed of trust involved in Whitcombe.

THE QUESTIONS PRESENTED ARE SUBSTANTIAL.

A. The Nationwide Impact of the Questions Presented.

The Home Owners' Loan Act of 1933 (15 U.S.C. § 1461 *et seq.*) ("HOLA") was born of the Great Depression. In the early 1930's the thrift industry was in disarray. Federal savings and loan associations did not exist. Thousands upon thousands of homeowners faced the loss of their homes due to the defects of the state chartered and regulated savings and loan system. State savings and loan associations made short term home loans with no assurance of refinancing when the loans came due, as well as home loans to be repaid from sinking funds. When the state savings and loan associations failed under the pall of the Depression new loans to replace loans then due were unavailable, and the full balance of loans remained due when the sinking funds designed to retire those loans were lost by the associations' failure. In the ensuing havoc as many as 40% of the Nation's home loans were in default.[5]

Congress responded to this catastrophic situation with a series of enactments designed to remedy the then existing problem and to ensure that such a situation would not thereafter reoccur. The Home Owners' Loan Act of 1933 was the most significant part of this effort. The Home Owners' Loan Act of 1933 empowered the Federal Home Loan Bank Board ("Bank Board") to create, for the first time, federally chartered savings and loan associations. The Bank Board was given by Congress, through the HOLA, broad authority to supervise and regulate these new federal associations in accordance with the "best practices" of the nation's home financing industry. 12 U.S.C. § 1464(a). This was done by Congress to insure that the federal associations would be

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[5]*Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256, 1257-1258 (9th Cir. 1979), *aff'd.* 445 U.S. 921 (1980).

financially sound institutions unaffected by state practices which the Bank Board did not consider to be "best practices" for the federal associations.

The instant controversy arises from an effort to require Appellant, a federally chartered and regulated savings and loan association, to comply with California law which law the Bank Board has expressly found to be not a "best practice" and harmful to the financial soundness and stability of federal associations, and has expressly attempted to preempt by the adoption of regulations.

As noted in the Statement of the Case, the issue here is whether federal law, which includes specific preemptive federal regulations which contemplate the exercise of a due-on-sale clause for the purpose of raising interest rates has invalidated the application of California law to federal savings and loan association due-on-sale clause practices. The California Court of Appeal, Fourth District, has held that the law of California may be validly applied to the due-on-sale clause in mortgage contracts of federal associations. The Questions Presented by this unfortunate decision will have an impact not only in California, but in every state where the supremacy of the Bank Board regulation of federal association lending practices is not recognized.

In addition to the instant action there are presently pending in the California trial and appellate courts over 40 more cases against Appellant with respect to exercise of the due-on-sale clause in its mortgage contracts. In addition, there are well over 600 similar cases pending in the California courts against other federal associations. But, this issue does not involve only California. There are federal associations located in each of the fifty states. While the lending activities of federal associations have historically been geographically local, federal law permits federal associations to make loans

in all corners of the nation.[6] The federal trial courts have spoken with virtually one voice, ruling that state restraint on alienation laws cannot be validly applied to federal association due-on-sale practices because of preemptive federal law.[7]

The conflict between state and federal courts on this issue[8] and the vagaries among the states (which runs from California's prohibition against automatic exercise of the due-on-sale clause to Nebraska's endorsement of the clause for

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[6]Depository Institutions Deregulation and Monetary Control Act of 1980, Public Law 96-221, 94 Stats. 132, Title IV, Sec. 401.

[7]*First Fed. Sav. and Loan Ass'n of Gadsden County v. Peterson*, 516 F. Supp. 732 (N.D. Fla. 1981); *Dantus v. First Federal Savings and Loan Ass'n of Denver*, 502 F. Supp. 658, 661 (D. Colo. 1980); *Williams v. First Federal Savings and Loan Ass'n of Arlington*, 500 F. Supp. 307 (E.D. Va. 1980), *aff'd*, 651 F.2d 910 (1981); *Bailey v. First Federal Savings and Loan Ass'n of Ottawa*, 467 F. Supp. 1139 (C.D. Ill. 1979); *First Federal Savings and Loan Ass'n of Phoenix v. Development & Management Enterprises, Inc.*, No. CIV 79-880 PHX-EHC (D. Ariz., April 2, 1981) [unreported opinion]; and *Great Western Union Fed. Sav. and Loan Ass'n v. Walters*, No. C 79-906V (W.D. Wash., June 18, 1980) [unreported opinion]. Some state courts have reached the same conclusion. See *Haugen v. Western Fed. Sav. and Loan Ass'n of Denver*, No. 80 CA 9551 (Colo. Ct. App., April 30, 1981) [unreported opinion]; *First Federal Sav. and Loan Ass'n of Rochester v. Jenkins*, No. 80-354 (State of N.Y. Supreme Court, County of Tompkins, Feb. 19, 1981) [unreported opinion]; *Northwestern Fed. Sav. and Loan Ass'n v. Ternes*, No. 12,694 (Dist. Ct. So. Cen. Jud. of N.D., March 12, 1981) [unreported opinion]; and *Fischer v. First Fed. Sav. and Loan Ass'n of Lewanee County*, No. 80-01-756 (Circuit Ct., Lewanee Co., Mich., Jan. 19, 1981).

[8]In addition to the instant matter, other recent published decisions upholding the validity of applying state law to federal savings and loan association due-on-sale practices notwithstanding the Bank Board regulations include *Holiday Acres No. 3 v. Midwest Federal Savings and Loan Ass'n of Minneapolis*, 308 N.W. 2d 471 (Minn. Sup. Ct. 1981); *Panko v. Pan American Fed. Sav. and Loan Ass'n*, 119 Cal. App. 3d 916, 174 Cal. Rptr. 240 (1981); and *First Fed. Sav. and Loan Ass'n of Inglewood v. Lockwood*, 385 So.2d 156 (Fla. Ct. of App. 1980).

all associations)[9] should be resolved. Federal associations must know what the rule is to be not only within their home state but also in all of the states where they might choose to transact lending business. Only this Court can make clear that the Bank Board's regulations control uniformly throughout the nation.

The questions presented here are substantial not only because of the impact their resolution will have on the Nation's federal savings and loan associations, but also due to the impact on the secondary mortgage market. The secondary mortgage market involves the sale by savings and loan associations, and others, of home mortgage loans to investors in order to generate cash so that more home loans can be made by the selling association.

The importance of the secondary market has been recognized by Congress. The secondary mortgage market provides cash to savings associations to use in making new home loans for the purpose of meeting the Nation's housing needs. The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association were created by Congress to purchase mortgage loans from savings asso-

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[9]*See, Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978) [prohibiting automatic exercise of due-on-sale clauses], *contra, Occidental Sav. and Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W. 2d 843, (Neb. S. Ct. 1980) [due-on-sale clauses are not restraints on alienation and are in fact enforceable absent pleading and proof by the mortgagor that such enforcement would be inequitable]. Other state decisions validating automatic enforcement of due-on-sale clauses for all associations include *Malouff v. Midland Federal Sav. & Loan Ass'n*, 181 Colo. 294, 509 P. 2d 1240 (1973); *Baker v. Loves Park Sav. & Loan Ass'n*, 61 Ill.2d 119, 333 N.E.2d 1 (1975); *First Commercial Title, Inc. v. Holmes*, 92 Nev. 363, 550 P. 2d 1271 (1976); *Century Federal, Sav. & Loan Ass'n v. Van Glahn*, 144 N.J. Super. 48, 364 A. 2d 558 (1976); *Stith v. Hudson City Sav. Institution*, 63 Misc.2d 863, 313 N.Y.S.2d 804 (1970); *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, 224 S.E.2d 580 (1976); *Gunther v. White*, 489 S.W. 2d 529 (Tenn., 1973); *Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wireworks*, 71 Wis. 2d 531, 239 N.W. 2d 20 (1976).

ciations. The Federal Home Loan Mortgage Corporation alone purchased over 20 billion dollars in home mortgages between 1970 and 1980 with almost 50% of these mortgages involving California real property. These mortgage loans are pooled and in effect resold to private investors. The number of years remaining on a mortgage loan affects its price — *i.e.* its investment value — to the private investor. The shorter the term remaining the higher is the value of the note when the note is sold at a discount. The automatic exercise of the due-on-sale clause has the effect of reducing the number of years remaining on the note since historically most people sell their homes well before the 25 or 30 year term of the mortgage note has expired. State laws which preclude automatic exercise of the due-on-sale clause make the loans of the associations subject to those laws less valuable in the secondary market. The laws have the effect of inhibiting the flow of new dollars into the housing market.

The questions presented here are further substantial as their resolution will directly impact the ongoing efforts of the Bank Board to save the savings and loan industry (and particularly the federally chartered part of that industry) from the current economic assault on its fiscal integrity caused by prevailing economic circumstances. The Bank Board has, in addition to the due-on-sale regulations, adopted other regulations designed to maintain the solvency of federal associations during times of high interest rates. The recently adopted adjustable mortgage loan regulations (12 C.F.R. § 545.6-4) permit federal associations to make loans whose interest rates can fluctuate greatly in magnitude on a monthly basis. State laws to the contrary are expressly preempted by the regulations. Yet, if the opinion below is permitted to stand these and all similar federal regulations which purport to affect the duration, terms, or conditions

of a federal association's home mortgage loans will be rendered meaningless. The Bank Board's effort to protect the fiscal integrity of the federal savings and loan industry will go for naught. Federal associations will be compelled to yield to the adverse practices of the various states.[10]

The importance of this Court's intervention is required not only by the magnitude of the problem, but also by the egregiously wrong decision entered by the court below.

The California Court of Appeal held that Congress did not intend the Home Owners' Loan Act of 1933 to be preemptive of state law (except as to the internal operation of federal associations), that the Bank Board due-on-sale regulations were not preemptive of state law since they related to the external activities of a federal association, and that in any event by including the law of the jurisdiction clause in certain of their loan documents only state law was applicable to those transactions. The California Court's conclusions are in each and every respect in serious error, in that the Court in reaching each conclusion ignored or misconstrued the prior teachings of this Court.

B. The Preemption Doctrine.

At the heart of this action is the preemption doctrine which emanates from the Supremacy Clause of the United States Constitution (Art. VI, cl. 2). By reason of the Supremacy Clause, if Congress has the constitutional power to act, and intends that its act be controlling, then the Supremacy Clause makes it so. State law to the contrary is preempted.

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[10]The Comptroller of the Currency has proposed similar due-on-sale regulations for national banks. 46 Federal Register 46964, September 23, 1981. If the opinion below is permitted to stand, these regulations, even if adopted will be stillborn.

The issue here is one of intent. Congressional intent to preempt can be explicitly declared on the face of the legislation, or it may be implied. Preemption "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977).

Congress may demonstrate an implicit intent to preempt in several ways. Congress may enact legislation expressing general objectives and empower a federal agency to issue regulations for the purpose of making the legislation effective. Regulations intended by the federal agency to displace state law will do so, provided the regulations are not inconsistent with the general objectives of the legislation. *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978); *United States v. Shimer*, 367 U.S. 374 (1961).

In addition, Congress may evidence an implicit intent to preempt where the pervasive nature of the legislation makes reasonable the conclusion that state law should not validly apply, or the federal act may involve a matter of overriding federal interest, or the objective Congress sought to achieve by its legislation may also disclose the intended inapplicability of state law. *Rice v. Santa Fe Elevator Corporation*, 331 U.S. 218, 230 (1947). *See also, Jones, supra*, 430 U.S. at 525-526; *Bethlehem Steel Co. v. New York State Labor Relations Board*, 330 U.S. 767 (1947).

The unifying inquiry is: Has Congress in one manner or another intended federal law to control? If so, it matters not that Congress chose to express that intention implicitly as opposed to explicitly. In either event the result is identical. The state law at issue is preempted by the federal enactment.

C. The Federal Home Loan Bank Board Regulations Preempt California Law.

Federal regulations preempt state law when their preemptive intent is clear and the regulations are not inconsistent with federal law. *Ray v. Atlantic Richfield Co., supra; United States v. Shimer, supra.*

The federal regulations in issue here were fashioned by the Bank Board with the express intent to preempt state laws on the question of due-on-sale mortgage clauses. See Bank Board Resolution 76-296 (Appendix 43a, 45a). The California Court of Appeal's decision, from which this appeal is taken, ignored the ability of federal regulations to preempt state law where the terms of the regulation are not inconsistent with the purpose of the Congressional enactment. If the Bank Board due-on-sale regulations are not inconsistent with the purpose of the HOLA they must be treated for preemption purposes as having the force of any federal statute. *First Federal Savings and Loan Association of Boston v. Greenwald*, 591 F. 2d 417, 425 fn 11 (1st Cir. 1979). And, if those regulations are intended to preempt state law preemption will occur.

This Court's decision in *United States v. Shimer*, 367 U.S. 374 (1961), is illustrative. In *Shimer*, a case which also involved real property and mortgages, the issue was whether the Veterans Administration ("VA") regulations which permitted the government to obtain what amounted to a deficiency judgment following foreclosure would prevail over state law which precluded a deficiency judgment. This Court first concluded that the regulations were indeed designed by the VA to achieve the deficiency result claimed. The Court then concluded that as the VA was delegated the power to adopt regulations, and as the regulations were not inconsistent with the purpose of the enabling legislation,

those federal regulations were controlling, notwithstanding state law. 367 U.S. at 385.

In the instant case, pursuant to the broad regulatory authority conferred upon it the Bank Board adopted the due-on-sale regulations. *The Court of Appeal concluded that the Bank Board regulations were intended by the Bank Board to preempt state due-on-sale law.* (See Appendix at 15a). Thus, under *Shimer* the only question barring preemption was whether the regulations were inconsistent with the Bank Board's congressionally mandated authority. The California Court of Appeal ignored this question. Had the Court of Appeal asked, as it should have, whether the Bank Board due-on-sale regulations were inconsistent with the purpose of the Home Owners' Loan Act of 1933, the necessary negative answer would have produced a finding of preemption.

A significant purpose of the HOLA is the creation and maintainence of an economically viable federal savings and loan system. The Bank Board has concluded that the ability of a federal association to exercise a due-on-sale clause at the lender's option to increase interest rates is necessary to the stability of the federal savings and loan system. 12 C.F.R. § 556.9 (Appendix 42a). See also, Bank Board Resolution 75-647, the Schott Opinion, July 30, 1975, at 21-34 and 38-39.

Further support for the due-on-sale regulations as being not inconsistent with Congressional intent in enacting the HOLA is found in Congress' acquiescence in them. Congress has amended the HOLA after promulgation of these

regulations and left them undisturbed.[11] This too compels the courts to conclude the regulations comport with Congress's legislative intent. *See, Board of Governors of the Federal Reserve System v. First Lincolnwood Corp.*, 439 U.S. 234, 248 (1978); *N.L.R.B. v. Bell Aerospace Co.*, 416 U.S. 267, 274-75 (1974). Since the regulations in question are not inconsistent with the purpose of the HOLA, and since the regulations, as the California Court of Appeal found, were intended to preempt, a finding of preemption should have been unavoidable.

The Court of Appeal avoided that conclusion by arguing that because the federal regulations are not mandatory, but are included in the loan documents at the associations' option, that "the federal loan association is not faced with physical impossibility in complying with the two regulatory schemes . . ." (Appendix at 18a) and, therefore, there was no conflict between state and federal law as required for preemption to occur.[12] The permissive/mandatory distinction drawn by the Court below is a non sequitur. Under the analysis employed by this Court in *Shimer, supra*, the in-

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[11]Since 1976, for example, Congress has enacted at least six different amendments to § 5 of HOLA (12 U.S.C. § 1464). See Pub.L. 95-128, Title IV §§ 401-405, 91 Stat. 1136, 1137, Oct. 12, 1977; Pub.L. 95-147, § 2(a), 91 Stat. 1227, Oct. 28, 1977; Pub.L. 95-630, Title I, §§ 107(a)(3), (c)(3), (d)(3), (e)(3), 111(c), Title II, § 208(b), Title XII, §§ 1202, 1204, Title XVII, § 1701, 92 Stat. 3651, 3655, 3659, 3662, 3668-3670, 3675, 3710, 3711, 3714, Nov. 10, 1978; Pub.L. 96-153, Title III, §§ 325, 326, 93 Stat. 1121, Dec. 21, 1979; Pub.L. 96-161, Title I, § 102, 93 Stat. 1233, Dec. 28, 1979; Pub.L. 96-221, Title III, §§ 304, 307, Title IV, §§ 401-404, 407(a), 408, 94 Stat. 146, 147, 151, 155, 156, 158-160, Mar. 31, 1980.

[12]The Court of Appeal, in fixing on the physical impossibility test to find a conflict, totally overlooks this Court's alternative test to find a conflict. In *Ray, supra*, this Court held that a conflict would exist to support preemption when there is physical impossibility "*or* where the 'state law stands as an obstacle to the accomplishment or execution of the full purposes and objectives of Congress.' " *Ray, supra*, 435 U.S. at 158 (Emphasis added).

tention by the agency to displace state law by regulations not inconsistent with the HOLA should have resulted in preemption. A conflict was not necessary, but even if it were, a conflict exists. State law flatly precludes that which federal law embraces.

The fallaciousness of the Court of Appeal's permissive/mandatory dichotomy is fully demonstrated by the decision in *Meyers v. Beverly Hills Federal Savings & Loan Ass'n*, 499 F. 2d 1145 (9th Cir. 1974), a decision the Court of Appeal cited as correctly decided. (Appendix at 16a, 17a).

In *Meyers* the Bank Board regulation involved prepayment penalties for early repayment of mortgage loans. Significantly, the prepayment regulations involved in *Meyers* are as "permissive" as the due-on-sale regulations here:

> [*E*]*ach borrower* from federal associations on a loan secured by a home or combination of home and business property *shall have the right to prepay the loan without penalty unless the loan contract makes express provision for a prepayment penalty*.
>
> 499 F. 2d at 1147, quoting then 12 C.F.R. § 545.6-12(b). (Emphasis added)

There is absolutely *no difference* between the permissive quality of the prepayment regulations endorsed as preemptive in *Meyers* and the due-on-sale regulations involved here. The preemptive result obtained in *Meyers* should have logically been obtained here.

Perhaps, the most disturbing aspect of the Court's permissive/mandatory distinction is the danger that the permissive/mandatory dichotomy will provide first a loophole in the preemption doctrine and then a noose through which the head of federal regulation will be hung. Since many of the Bank Board's regulations dealing with the mortgage lending practices of federal associations are or may be both 1) permissive, and 2) contrary to the laws of various states,

the entire federal regulatory net governing federal associations (as well as federal regulations by other agencies in other areas) may be susceptible to destruction by reason of the California Court's misguided permissive/mandatory analysis.

D. The Home Owners' Loan Act of 1933 Preempts California Law.

i) This Court Has Conclusively Found That Congress Intended HOLA to Be Preemptive of State Law.

The Court of Appeal's decision finding no preemption is totally at odds with the decision in *Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff'd*, 445 U.S. 921 (1980).

The summary affirmance of that decision by this Court should have foreclosed the preemption question from further consideration. This Court's summary affirmance acts as a decision on the merits until this Court acts otherwise. *Hicks v. Miranda*, 422 U.S. 332, 343-345 (1975). Such summary affirmances ". . . prevent lower courts from coming to opposite conclusions on the precise issues presented and necessarily decided by those actions." *Mandel v. Bradley*, 432 U.S. 173, 176 (1977).

In *Conference v. Stein, supra*, the Conference, and numerous member federally chartered savings and loan associations, sought declaratory and injunctive relief alleging that California state law pertaining to non-discriminatory lending practices (anti-redlining regulations) were preempted by the HOLA and Bank Board regulations and thus the federal associations could not be required to comply with those state laws. Summary judgment was entered in favor of the plaintiffs and was affirmed by the Ninth Circuit Court of Appeals. The Ninth Circuit Court of Appeals squarely held that the HOLA was a comprehensive regulatory scheme

and that it was apparent from the language of the HOLA itself that it was the intent of Congress that the HOLA preempt all state laws which sought in any way to regulate or control the operation of federal savings and loan associations.

> In our judgment the regulatory control of the Bank Board over federal savings and loan associations is so pervasive as to leave no room for state regulatory control.
>
> * * *
>
> The broad regulatory authority over the federal associations conferred upon the Bank Board by HOLA does *wholly preempt the field of regulatory control over these associations*.
>
> 604 F.2d at 1260. (Emphasis added.)

Defendant Stein appealed the Ninth Circuit's decision to this Court. In the Jurisdictional Statement filed with this Court appellant Stein argued that the decision of the Ninth Circuit Court of Appeals was in error in that the HOLA does not provide a basis for preemption, and that the HOLA should not be found to preempt state law which seeks to regulate the "external" conduct of federal savings and loan associations. *See*, the Jurisdictional Statement at pages 24 through 31. Appellant Stein's protestations to the contrary, this Court summarily affirmed the Ninth Circuit's decision. Necessarily included within that preemption issue, and therefore decided by the summary affirmance, is the question of whether it was the *intent* of Congress that the HOLA preempt state law, *as a finding of preemption necessarily includes the determination that Congress intended preemption*. This Court's summary affirmance is a decision on the merits holding at the very least that the HOLA is preemptive of state laws which seek to affect the conduct of federal savings and loan associations already regulated by Bank

Board regulations, *and that such preemption was intended by Congress when it enacted the HOLA*.

Accordingly, the *Wellenkamp* interpretation of Civil Code § 711 cannot validly be applied to preclude automatic exercise of the due-on-sale clause by federal associations.

ii) The *Wellenkamp* Doctrine Is Hopelessly at Odds With the Purpose and Objectives of the Federal Law.

A direct express conflict between state and federal law is not the only conflict which can give rise to preemption. If the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress," the state law will be found so inconsistent with federal law that preemption must occur. *Jones, supra*, 430 U.S. 519, 526 (1977).

In the case at bar, the Court of Appeal failed to fully consider how the policies underlying *Wellenkamp* stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in adopting the HOLA. Those purposes and policies once examined and juxtaposed with the conflicting state policies underlying *Wellenkamp* demonstrate that preemption must occur.

The express purpose of Congress in enacting the HOLA is well known. As stated by the court in *West Helena Savings and Loan Assn. v. Fed. Home Loan Bank Board*, 417 F. Supp. 220 (E.D. Ark. 1976), *aff'd*, 553 F.2d 1175 (8th Cir. 1977):

> When Congress, in the special session of 1933, considered measures for the relief of homeowners under threat of dispossession, it was confronted with the almost equally urgent problem of devising ways and means to revive thrift and home financing. Immediate relief for distressed homeowners was provided by the refinancing operations of the Home Owners Loan Corporation. *However, to minimize the possibility of a*

recurrence of such a crisis, and to strengthen private home financing as an effective instrument of home ownership, assistance beyond temporary relief was imperative. Moreover, there were 1,555 counties in the United States — approximately one-half of the total number of counties — in which there were no local home financing institutions whatever.

The necessity of dealing with these problems induced Congress to embody in the Home Owners' Loan Act of 1933 provisions for the creation of Federal savings and loan associations as private institutions under Federal charter. The purpose of authorizing the establishment of these institutions was twofold: (1) to provide thrift where such facilities were unavailable or inadequate; *and (2) to combine under Federal charter the best policies and practices developed in the savings and loan industry during the 107 years of its experience. The organization, incorporation, and supervision of federal savings and loan associations were vested in the Federal Home Loan Bank Board.*

417 F. Supp. at 227 citing a 1938 Report of the Bank Board. (Emphasis added)

The history of the HOLA, therefore, reflects a strong Congressional intent that a primary purpose of the HOLA was the creation of federal savings and loan associations not bound to follow any state law infringing upon their lending activities or adversely affecting in any way their financial soundness. The simple question then becomes whether the state or federal approach to enforcement of the due-on-sale clause better meets that objective. Without a doubt the federal approach is superior, as only the federal approach protects the federal association. The state approach could actually lead to financial loss threatening the stability of the institution.

Automatic exercise of the due-on-sale clause permits associations to replace low yielding loans with higher yielding loans. In contrast, *Wellenkamp* requires associations to continue to carry low yielding loans even when to do so can cause serious economic loss to the associations.

In the case at bar, the state policies embodied in *Wellenkamp* undeniably clash with the federal policies embodied in the Congressional legislation. The California Court of Appeal could not engage in a legislative determination as to which policy is best. The California Court of Appeal could only take note of that clash and the impediment to the realization of federal policy raised by contrary state law. The Supremacy Clause will, as it must, assure that the survivor of the clash is federal law. Therefore, preemption should have been found on this basis by the California Court of Appeal. That it was not must be corrected.

iii) Federal Law Has Occupied the Field of Regulation of Federal Associations.

A Congressional intent to preempt may be implied from the pervasiveness of the federal regulation. *See, Jones v. Rath Packing Co., supra.* This "occupation of the field" analysis has been used by many courts to find preemption of state law as to federal savings and loan association activities. *See e.g., Conference of Fed. Sav. and Loan Ass'ns v. Stein*, 604 F. 2d 1256 (9th Cir. 1979), *aff'd*, 445 U.S. 921 (1980); *Meyers v. Beverly Hills Fed. Savings and Loan Association*, 499 F. 2d 1145 (9th Cir. 1974); *Rettig v. Arlington Heights Federal Savings and Loan Association*, 405 F. Supp. 819 (N.D. Ill. 1975); *City Federal Savings and Loan Association v. Crowley*, 393 F. Supp. 644 (E.D. Wis. 1975); *People of the State of Calif. v. Coast Fed. Sav. and Loan Ass'n.*, 98 F. Supp. 311 (S.D. Cal. 1951) and *Kaski*

v. First Federal Savings and Loan Association, 72 Wis. 2d 132, 240 N.W. 2d 367 (1976).[13]

The Court of Appeal avoided the conclusion of preemption which these authorities would seem to compel by making an arbitrary, artificial, and unsupportable distinction between the "internal" and "external" activities of federal associations. The California Court of Appeal asserted that the HOLA was only intended to enable the Bank Board to regulate the internal affairs of federal associations and not its external affairs. The Court then decided that federal association due-on-sale practices were external affairs not within the field occupied by the HOLA; state law, therefore, could control.

The California Court of Appeal cited in support of its conclusion that the law of the several states may not regulate or interfere only with the "internal" affairs of federal associations *Conference of Federal Savings and Loan Associations v. Stein*, 604 F. 2d 1256 (9th Cir. 1979), *aff'd*, 445 U.S. 921 (1980); *Meyers v. Beverly Hills Federal Savings & Loan Association*, 499 F. 2d 1145 (9th Cir. 1974); *Kaski v. First Federal Savings and Loan Association of Madison*, 72 Wis. 2d 132, 240 N.W. 2d 367 (1976); and *Derenco, Inc. v. Benjamin Franklin Federal Savings and Loan Association*, 281 Or. 533, 577 P. 2d 477 (1978).

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[13]The occupation of field analysis as to federally chartered associations has persisted for thirty years (since *People v. Coast Federal, supra*), yet, Congress has not undercut the preemptive fruits of that analysis. Indeed, one recent Congressional amendment to Section 5(a) of the HOLA, 12 U.S.C. § 1464(a)(1) (Pub. L. 95-630, § 1202), could have no purpose unless there was preemption. That section specifies that state mutual savings banks converted to federal charter from state charter must continue to comply with certain specified state laws. The legislative history of 12 U.S.C. § 1464(a)(1) makes it clear that section was meant to carve out an exception to exclusive federal regulation in the field. *See*, 124 *Cong. Rec. H.* 11744 (Oct. 5, 1978).

An analysis of these decisions demonstrates that: 1) none of these decisions discussed, let alone turned on, the artificial internal/external distinction made by the California Court of Appeal, and 2) even assuming that such a distinction legitimately can be made, the operation and regulation of the due-on-sale clause at issue here is no different in character or degree from the "internal" regulations found preemptive in the cited cases.

In *Conference*, the Court held that the federal association in its dealings with its borrowers and potential borrowers was not required to comply with certain state nondiscrimination laws. In *Meyers*, the court ruled that California laws limiting the prepayment penalties which could be imposed upon borrowers on early payment of their loans could not be applied to federal associations. In *Kaski* the court concluded that federal law, and not state law, would determine the legality of a variable interest rate provision in a promissory note given by a borrower to the federal savings and loan association. Finally, in *Derenco* the Oregon Supreme Court determined that federal law, and not state law, would determine the duty of the federal association to pay interest on impound accounts required by the association in connection with real estate mortgage transactions between the association and its real estate borrowers.

In *each* of the foregoing cases the regulations at issue dealt with the terms and conditions of the lending relationship between the associations and its borrowers. Here, the due-on-sale clause and the Bank Board regulations likewise deal with the terms and conditions of the lending relationship between the association and its borrower. The due-on-sale clause is no less "internal" than the provisions considered by the above-noted courts. Conversely put, the provisions considered by the above-noted courts and found to be

preemptive of state law are as much "external" as the due-on-sale clause.

The internal/external distinction is destroyed by *Conference*. The appellant, Stein, argued to this Court that the HOLA only pertained to internal regulation of federal associations. (Jurisdictional Statement at 28.) The summary affirmance was a rejection of Stein's assertion. Yet, even in the face of this highest precedent totally undermining the internal/external distinction the California Court of Appeal persisted with its ill-conceived notion. Plenary consideration is needed to insure that the scope of the HOLA as intended by Congress is not artificially and inappropriately truncated by the California Court's decision.

E. The "Law of the Jurisdiction" Clause Does Not Preclude a Finding of Preemption.

The *Moore* deed of trust contains the following clause:

> [T]he Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located.

This Court stated more than 100 years ago that the law of a state necessarily also includes preemptive federal law, to the exclusion of preempted state law. *See, Hauenstein v. Lynham*, 100 U.S. 483 (1880). Therefore in the case at bar, preemptive federal regulations permitting the unfettered exercise of due-on-sale clauses by federal associations are part of the "law of the jurisdiction," and at the same time, preempted state law is excluded.

The California Court of Appeal acknowledged the existence of *Hauenstein* but nonetheless held that only local California law applied.[14] The Court thereby ignored prec-

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[14]In addition to *Hauenstein*, Appellants also cited several more recent California decisions which reached the same result as did this Court in *Hauenstein*.

edent which has existed for over 100 years and in the process emasculated the Supremacy Clause. Plenary consideration is necessary to reassert the vitality of the Supremacy Clause and to insure that state courts continue to pay heed to the valid decisions of this Court, no matter how old those decisions might be.

CONCLUSION.

As has been demonstrated, the questions presented by this appeal are of nationwide importance. The correct resolution of these questions are of substantial significance to the parties here, to the Bank Board, and to the secondary mortgage market. The resolution of these questions will also have general impact as to all areas where Congress has empowered a federal agency or board to carry into effect the intent of Congress. These questions are certainly sufficiently substantial as to call for plenary consideration. Appellants respectively urge this Court to provide that consideration, to note probable jurisdiction, and to reverse the erroneous and dangerous decision of the California Court of Appeal, Fourth District.

Dated: October 20, 1981.

Respectfully submitted,

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Appendix

APPENDIX

California Court of Appeal Decision.

[Civ. No. 23253. Fourth Dist., Div. Two July 2, 1981.]

Reginald D. de la Cuesta et al., Plaintiffs and Appellants, v. Fidelity Federal Savings and Loan Association, Defendant and Respondent. Alphonso Moore et al., Plaintiffs and Appellants, v. Fidelity Federal Savings and Loan Association, Defendant and Respondent. John D. Whitcombe, Plaintiff and Appellant, v. Fidelity Federal Savings and Loan Association, Defendant and Respondent.

SUMMARY

In each of three consolidated cases against a federally chartered savings and loan association, the purchaser of real property encumbered by a deed of trust sought declaratory and injunctive relief against threatened foreclosure by trustee's sale following defendant's purported exercise of the trust deed's due-on-sale clause. Plaintiffs moved for summary judgment, asserting that state law precluded defendant association from exercising the due-on-sale clauses absent a showing of an impairment to its security or risk of default as a result of the outright sale of the properties to plaintiffs. While conceding that it could not make such a showing, thus rendering the due-on-sale clauses unenforceable under state law, defendant made cross-motions for summary judgment on the ground that the application of state law was precluded by federal preemption. The trial court granted defendant's motion in each case. (Superior Court of Orange County, Nos. 286474, 306349, 308527, Edward J. Wallin, Judge.)

The Court of Appeal reversed. The court held that the state law limitation on the enforcement of due-on-sale clauses in deeds of trust to instances when the lender can demonstrate that enforcement is reasonably necessary to

protect against impairment to its security or the risk of default is not preempted by federal regulations authorizing federal savings and loan associations to include a due-on-sale clause in their loan contracts and to exercise their rights thereunder and requiring that loan instruments provide for full protection to the lender, or on the basis of the "occupation of the field" doctrine, and is thus applicable to federal savings and loan associations. In so holding, the court noted that the Home Owners' Loan Act (12 U.S.C. §§ 1461-1470; creating the Federal Home Loan Bank Board and authorizing establishment of federal savings and loan associations) is silent with respect to due-on-sale clauses or other loan details and that state law pertaining to the exercise of due-on-sale clauses does not infringe upon and is not otherwise incompatible with the regulation or control of federal savings and loan associations. The court also held that the state law at issue is applicable to commercial as well as residential real property. (Opinion by Kaufman, Acting P. J., with McDaniel and Morris, JJ., concurring.)

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OPINION

Kaufman, Acting P. J. —

INTRODUCTION

This is an appeal from summary judgment in favor of defendants in three cases consolidated in the trial court. Where appropriate, the cases will be referred to as the *de la Cuesta* case, the *Moore* case, and the *Whitcombe* case. Each action was commenced by the purchaser of property encumbered by a deed of trust seeking declaratory and injunctive relief against threatened foreclosure of the deed of trust by trustee's sale following the purported exercise of the trust deed's due-on-sale clause. The principal defendant in each action is the beneficiary named in the deed of trust, Fidelity Federal Savings and Loan Association, and the defendants will be referred to collectively as Fidelity Federal. The plaintiffs made motions for summary judgment asserting that in the absence of any showing it was reasonably necessary to avoid impairment of the security or risk of default resulting from the sale, Fidelity Federal was precluded from exercising the due-on-sale clause by the California law as set forth in *Wellenkamp v. Bank of America* (1978) 21 Cal.3d 943 [148 Cal.Rptr. 379, 582 P.2d 970]. The trial court granted Fidelity Federal's cross-motion for summary judgment on the ground that application of the state law is precluded by federal preemption.

The principal issues are whether the trial court correctly determined that application of the state law has been federally preempted and, in the Moore and Whitcombe cases, the effect of a provision in each deed of trust that it "shall be governed by the law of the jurisdiction in which the Property is located." A determination that there has been no federal preemption of the state law raises an additional issue in the de la Cuesta case as to whether or not the rule

announced in *Wellenkamp* applies to commercial, income-producing property. We have concluded that application of the state law has not been federally preempted and that the *Wellenkamp* rule does preclude exercise of the due-on-sale clause in the deed of trust encumbering the commercial property involved in the de la Cuesta case. Accordingly, we reverse the judgment as to each case with directions to the trial court to enter summary judgment in favor of the plaintiffs.

On June 1, 1981, after oral argument and after unanimous agreement of the panel members as to the proper disposition of the issues and the appeal, but before the opinion could be prepared, Division One of the First Appellate District of the Court of Appeal filed its opinion in the case of *Panko v. Pan American Fed. Sav. & Loan Assn.* (1981) 119 Cal.App.3d 916 [174 Cal.Rptr. 240]. In that case in respect to the federal preemption issue the court reached conclusions identical to those reached by us, based on reasoning with which we agree. The reasons and conclusions were ably and succinctly stated in the *Panko* opinion, and it would serve no useful purpose for us to attempt to craft a wholly original opinion. On the other hand, inasmuch as the *Panko* decision is not yet final, it is inappropriate that we simply cite it as controlling authority. We have, therefore, resolved to adopt substantial portions of the language of the *Panko* opinion as our own with appropriate additions and deletions. To avoid the necessity of a multitude of quotes and internal quotes, we simply here state that the substantive portions (as opposed to the statement of fact and disposition) of part I of this opinion, including footnotes, are quoted from the *Panko* decision except for material enclosed in brackets, including footnotes, which we have added. Deletions from quotations from the *Panko* opinion, other than the deletion

of the name of Pan American and the substitution therefor of Fidelity Federal, will be indicated by ellipses or other appropriate designation.

I — The Moore Case

A. *THE FACTS*

A fact common to all three cases is that Fidelity Federal is a private mutual savings and loan association chartered by the Federal Home Loan Bank Board pursuant to section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. §§ 1461-1470).

On February 22, 1978, Fidelity Federal made a loan of $58,800 to Paul M. and Debra J. Stitch secured by a deed of trust on their residential real property at 3109 Roosevelt Way, Costa Mesa, in the State of California. The deed of trust contained a due-on-sale clause purportedly giving Fidelity Federal the right to declare the unpaid balance of the loan immediately due and payable in the event the property was sold or otherwise transferred or conveyed by the borrowers.

The deed of trust also contained a provision identified as paragraph 15 stating that the deed of trust "shall be governed by the law of the jurisdiction in which the Property is located."[1]

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[1][In full the provision reads: "Uniform Deed of Trust; Governing Law; Severability. This form of deed of trust combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located. In the event any provision or clause of this Deed of Trust or Note conflicts with applicable law, such conflicts shall not affect other provisions of this Deed of Trust or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Deed of Trust and the Note are declared to be severable."]

On September 15, 1978, the Stitches sold and, by grant deed, transferred the property to plaintiffs Alfonso Moore and Alice Moore.

Having learned that the property had been sold and conveyed to the Moores, Fidelity Federal gave notice of its intention to exercise the due-on-sale clause in the deed of trust and on December 7, 1978, caused to be recorded a notice of default and election to sell under the deed of trust. Whereupon, the Moores instituted this action.

B. *FEDERAL PREEMPTION*

Background

In recent years the validity of due-on-sale clauses has been a matter of considerable controversy in state and federal courts. In California our Supreme Court has determined that enforcement of a due-on-sale clause upon occurrence of an outright sale constitutes an unreasonable restraint on alienation "unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default." (*Wellenkamp v. Bank of America, supra*, 21 Cal.3d at p. 953.) The court's decision was grounded on Civil Code Section 711,[2] . . . [which, as interpreted, invalidates unreasonable restraints on the alienation of real property. (21 Cal.3d at p. 948.)]

Here, [Fidelity Federal makes no claim] . . . of an impairment to its security or risk of defaultt as a result of the outright sale of the property to plaintiffs. Consequently, under California law the due-on-sale clause contained in the deed of trust herein would not be enforceable. [Fn. omitted.] [Fidelity Federal] . . . contends that it can not be bound by California law since it is exclusively governed by regulations

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[2]Section 711 of the Civil Code provides: "Conditions restraining alienation, when repugnant to the interest created, are void."

of the Federal Home Loan Bank Board (Board) which preempt conflicting state laws.

In 1933 the Home Owners' Loan Act [HOLA] (12 U.S.C. §§ 1461-1470) was enacted by Congress . . . authorizing the establishment of federal savings and loan associations. While the associations are specifically empowered to extend real estate loans (12 U.S.C. § 1464(c)(1)(B) and (c)(2)(A)), the statute is silent with respect to due-on-sale clauses or other loan details.

The Board [created in 1932 by the Federal Home Loan Bank Act (12 U.S.C. §§ 1421-1449)] is statutorily authorized to promulgate regulations[4] . . . ["to provide for the organization, incorporation, examination, operation, and regulation of" federal savings and loan associations. (12 U.S.C. § 1464(a)(1).] [From 1933 to June 8, 1976, the Board's regulations were silent with respect to due-on-sale clauses.][2] The first specific mention of due-on-sale clauses, . . . [appears in] a regulation . . . enacted [June 8, 1976 and] . . . effective July 1, 1976, [purporting to restrict the exercise of due-on-sale clause in certain circumstances and] providing [in part] as follows: "An association *continues to have the power to include, as a matter of contract between*

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[4]"In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations,' or 'Federal mutual savings banks' (but only in the case of institutions which, prior to conversions, were State mutual savings banks located in States which authorize the chartering of State mutual savings banks, provided such conversion is not in contravention of State law), and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States." (12 U.S.C. § 1464,(a)(1).)

[2][However, the Board has interpreted a 1948 regulation calling for provisions in the loan contract "for full protection to the . . . association" as authorizing the use and automatic exercise of due-on-sale clauses and, indeed, as preempting state law. (See discussion *infra*.)]

it and the borrower, a provision in its loan instrument whereby the association may, as its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. Except as provided in paragraph (g) of this section [restricting exercise of due-on-sale clauses] with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by the association of such option (hereafter called a due-on-sale clause) *shall be exclusively governed by the terms of the loan contract*, and all rights and remedies of the association and borrower *shall be fixed and governed by that contract*." [Italics added.] (12 C.F.R. § 545.6-11(f), amended and recodified at § 545.8-3(f)(1980).)

The pivotal question to be decided is whether the federal regulation overrides state law embodied in California Civil Code section 711, as interpreted in *Wellenkamp*.

Federal Preemption

The preemption doctrine arises under the supremacy clause of the federal constitution which states: "This Constitution, and the [L]aws of the United States which shall be made in [P]ursuance thereof; . . . shall be the supreme [L]aw of the [L]and; and the Judges in every State shall be bound thereby, any [T]hing in the Constitution or [L]aws of any State to the [C]ontrary notwithstanding." (U.S. Const., art. VI, cl. 2.) But the enumerated powers of the federal government are expressly limited: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people." (U.S. Const., Amend. X.) The United States Supreme Court has exhibited considerable

restraint in finding federal preemption of state law by requiring either "such actual conflict between the two schemes of regulation that both cannot stand in the same area, [or] . . . evidence of a congressional design to preempt the field." (*Florida Avocado Growers v. Paul* (1963) 373 U.S. 132, 141 [10 L.Ed.2d 248, 256, 83 S.Ct. 1210]; accord *People v. Conklin* (1974) 12 Cal.3d 259, 264 [114 Cal.Rptr. 241, 522 P.2d 1049], app. dism. 419 U.S. 1064 [42 L.Ed.2d 661, 95 S.Ct. 652].)

With reference to congressional intent, the United States Supreme Court has declared that a state regulation exercising the state's "historic police powers" is not displaced by federal law "unless that was the clear and manifest purpose of Congress." (*Jones v. Rath Packing Co.* (1977) 430 U.S. 519, 525 [51 L.Ed.2d 604, 613-614, 97 S.Ct. 1305]; *Rice v. Santa Fe Elevator Corp.* (1947) 331 U.S. 218, 230 [see also *New York Dept. of Social Services v. Dublino* (1973) 413 U.S. 405, 413-415 (37 L.Ed.2d 688, 695-696, 93 S. Ct. 2507)].) Counsel have not . . . [pointed out nor have we discovered] evidence of a clear congressional mandate that federal [rather than state] law shall control the . . . [determination as to whether the exercise within a state by a federally chartered savings and loan of a due-on-sale clause in the absence of any impairment or threat of impairment to its security is invalid as an unreasonable restraint on the alienation]. While the Congress [in HOLA] has unequivocally expressed its preemptive design in relation to specific areas of savings and loan association activities,[5] . . .

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[5]The Home Owners' Loan Act specifically provides that federal savings and loan associations are exempt from state limitations on the number of branch offices (12 U.S.C. § 1464(a)(1), but are not exempt from more stringent state laws on neighborhood discrimination or consumer credit protection. (*Ibid.*) Further, federal savings and loan associations are exempt from state taxation greater than that imposed on local financing institutions. (*Id.*, at § 1464(h).)

[HOLA] makes no reference to the subject of due-on-sale clauses.

[Invoking the somewhat discredited "occupation of the field" doctrine (see *Derenco, Inc. v. Benj. Franklin Fed. Sav. & Loan Ass'n* (1978) 281 Ore. 533 [577 P.2d 477, 484]; see also *New York Dept. of Social Services v. Dublino, supra,* 413 U.S. at pp. 413-415 [37 L.Ed.2d at pp. 695-696, 93 S. Ct. 2507]; see generally O'Connell, *The Due-On-Sale Clause in Florida: A Potential Battleground for Borrowers and Lenders* (1979) 31 Univ. of Fla. L.Rev. 933, 957-959), defendants emphasize the broad delegation of authority from Congress to the Board found in section 5(a) of HOLA (12 U.S.C. § 1464(a)(1)) to promulgate rules and regulations "to provide for the organization, incorporation, examination, operation and regulation of associations" (see fn. 4, *ante*). But this mistakes the plenary authority of the Board to regulate and control federal savings and loan associations (see, e.g., *Conference of Federal Sav. & Loan Ass'ns v. Stein* (9th Cir. 1979) 604 F.2d 1256, 1257-1258, 1260, affd. (1980) 445 U.S. 921 [63 L.Ed.2d 754, 100 S.Ct. 1304]; *Kupiec v. Republic Federal Savings & Loan Ass'n* (7th Cir. 1975) 512 F.2d 147, 150; *Glendale Fed. Sav. & Loan Ass'n v. Fox* (C.D. Cal. 1978) 459 F. Supp. 903, 909, judgment entered (1979) 481 F. Supp. 616, app. pending 9th Cir.); *Rettig v. Arlington Hgts. Fed. Sav. & Loan Ass'n* (N.D.Ill. 1975) 405 F. Supp. 819, 823), which no one questions, with the intent of Congress to supplant the laws of all 50 states pertaining to real property and mortgages, areas of fundamental state concern traditionally governed exclusively by state law. (See, e.g., *State Land Bd. v. Corvallis Sand & Gravel Co.* (1977) 429 U.S. 363, 378-379 [50 L.Ed.2d 550, 563, 97 S.Ct. 582]; *United States v. Little Lake Misere L. Co.* (1973) 412 U.S. 580, 591-592 [37 L.Ed.2d 187, 196, 93 S.Ct. 2389].) It is one

thing to say that Congress has given the Board plenary authority to regulate federally chartered savings and loan associations. It is another thing entirely to say that by virtue of its federal charter, a federal savings and loan association is not required to abide by the state law of real property and mortgages in the state in which it does business.[3]

[Moreover, the occupation of the field argument overlooks both a fundamental problem that would exist were the argument accepted and the historical use of and compliance with state law of real property and mortgages by federal savings and loan associations. When federal preemption is declared on the basis of "occupation of the field," no state law pertaining to the "field" is applicable, whether or not it conflicts with the federal law. (*Meyers v. Beverly Hills Federal Savings & Loan Ass'n* (9th Cir. 1974) 499 F.2d 1145, 1146; *Glendale Fed. Sav. & Loan Ass'n v. Fox, supra*, 459 F.Supp. at p. 907; *Derenco, Inc. v. Benj. Franklin Fed. Sav. & Loan Ass'n, supra*, 577 P.2d at p. 484.) But federal savings and loan associations have always used and been governed by state real property and mortgage law in respect to such matters as title, conveyancing, recording, priorty of liens, proceedings for foreclosure, and deficiency judgments. (See, e.g., *In re Wilton-Maxfield Management Co.* (9th Cir. 1941) 117 F.2d 913 [antideficiency statute]; *Federal National Mortgage Association v. Kostrunek* (S.D. Iowa 1964) 228 F. Supp. 777 [methods of foreclosure and right of redemption]; *Tahoe Highlander v. Westside Fed. Sav. & L.* (1979) 95 Nev. 8 [588 P.2d 1022] [antideficiency

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[3][Usually federal savings and loan associations do business wholly within one state. (See 12 C.F.R. § 545.6-6, amended and recodified as § 545.8-6.) There are about 10 savings and loan associations which, by reason of their preexisting status upon conversion, have branches outside their home state. (Hearing before the House Com. on Banking, Finance and Urban Affairs on H.R. No. 3864, 96th Cong., 1st Sess., at p. 163 (1979).)]

law]; *Benj. Franklin Federal S. & L. Ass'n v. Almond* (1978) 282 Ore. 303 [577 P. 2d 937] [prior decree no bar to foreclosure suit]; *Caudle v. First Federal Sav. & L. Ass'n of Sylacauga* (1976) 295 Ala. 409 [327 So.2d 911] [statutory right of redemption]; *Minn. Fed. Sav. v. Cent. Enter. of Superior* (1976) 311 Minn. 46 [247 N.W.2d 46]; *Hartford Federal Savings and Loan Ass'n v. Lenczyk* (1966) 153 Conn. 457 [217 A.2d 694] [antideficiency law]; *Apex Siding & Roof. Co. v. First Federal Sav. & L. Ass'n* (Okla. 1956) 301 P.2d 352 [equitable estoppel to assert priority]; *Anatole Caron, Inc. v. Manchester Federal Sav. & L. Ass'n* (1940) 90 N.H. 560 [10 A.2d 668] [mechanic's lien law]; *First Federal Savings & L. Ass'n of Martin Cty. v. Ott* (Fla.App. 1973) 285 So.2d 695, cert. den. (Fla. 1974) 291 So.2d 10 [constructive notice]; *Home Fed. Sav. & L. Ass'n v. Four Star Heights, Inc.* (1971) 70 Misc.2d 118 [333 N.Y.S.2d 334] [mechanic's lien law]; *Penn Federal Savings and Loan Ass'n v. Joyce* (1962) 75 N.J.Super. 275 [183 A.2d 114] [statutory and equitable rights of redemption]; *Kankakee Federal Sav. & L. Ass'n v. Arnove* (1943) 318 Ill.App. 261 [47 N.E.2d 874] [priority and subordination agreement]; *First Fed. Sav. & L. Ass'n v. Green-Acres Bldg. Corp.* (1963) 38 Misc.2d 149 [236 N.Y.S.2d 1009] [priority of lien under future advances clause].) In the event of a foreclosure, a federal savings and loan association would undoubtedly also be subject to state law in obtaining possession of the property. And it can hardly be otherwise, for there is no federal common law of mortgages or real property. (See *Kirkland v. Fidelity Federal Sav. & Loan Ass'n of Jacksonville* (D.Fla. 1980) ___ F.Supp. ___ , ___ ; see also *Hoopeston Co. v. Cullen* (1943) 318 U.S. 313, 318 [87 L.Ed. 777, 783, 63 S.Ct. 602, 145 A.L.R. 1113].)

[The *Wellenkamp* decision, of course, was based on California Civil Code section 711, the source of California law

on the validity of restraints against alienation of real property (see *Wellenkamp v. Bank of America, supra,* 21 Cal.3d at pp. 948, 949; *Coast Bank v. Minderhout* (1964) 61 Cal.2d 311, 316 [38 Cal.Rptr. 505, 392 P.2d 265], overruled to the extent inconsistent on another point in *Wellenkamp v. Bank of America, supra,* 21 Cal.3d at p. 953), and is part of the California law of real property and mortgages.

[We consider next the contention that the Board in its regulations and rulings has expressly preempted application of the state law.

[Notwithstanding that its regulations had not theretofore mentioned due-on-sale clauses, on July 30, 1975, by resolution number 75-647 in the form of an advisory opinion rendered at the request of the court in a case entitled *Eric R. Schott, et al. v. Mission Federal Savings and Loan Association, et al.* in the United States District Court for the Central District of California (case No. CIV-75-366 WMB) the Board interpreted the "full protection" language in a regulation in effect since 1948 "as authorizing 'due on sale' clauses for Federal associations (regardless of any State law to the contrary) because, . . . such clauses 'provide for full protection to the Federal association.' " (Advisory opinion, p. 15.) As stated by the Supreme Court of Minnesota in its opinion filed April 3, 1981, in *Holiday Acres v. Midwest Fed. Sav. & Loan Ass'n.*: "We reject [defendants'] argument that state regulation of the exercise of due-on-sale clauses was preempted prior to 1976 by [the] regulation which states, 'Loan instruments shall . . . provide for full protection to the Federal association.' 12 C.F.R. § 545.8-3(a). This language, in the context of the regulation cited, refers to insurance, taxes, assessments, repairs, and other factors enumerated in that section." Minn. __ [__N.W.2d

— , —])[4] Moreover, there is no conflict whatever between the "full protection" regulation and the California law. California law does not invalidate all exercises of due-on-sale clauses; only unreasonable restraints on alienation are held invalid (*Wellenkamp v. Bank of America, supra,* 21 Cal. 3d at p. 948; *La Sala v. American Sav. & Loan Assn* (1971) 5 Cal. 3d 864, 878-879 [97 Cal. Rptr. 849, 489 P.2d 1113]); the exercise of a due-on-sale clause is permitted when "the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default." (*Wellenkamp v. Bank of America, supra,* 21 Cal.3d at p. 953, fn. omitted.)

[While involved in litigation with officials of the State of California concerning the exercise by federal savings and loan associations of due-on-sale clauses, the Board on June 8, 1976, promulgated its due-on-sale clause regulation. (12 C.F.R. § 545.6-11(f), amended and recodified as § 545.8-3(f) (1980)) (See text following fn. [2], *ante*.) Although the regulation itself expressly states that "exercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by that contract," in a preamble accompanying the regulation the Board stated:

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[4][12 C.F.R. § 545.6-11, amended and recodified as § 545.8-3 (1980), reads in pertinent part: "(a) *Required and authorized provisions*. Each loan shall be evidenced by note, bond or other instrument and be secured by a security instrument which is consistent with sound lending practices. Loan instruments shall comply with applicable provisions of law, governmental rules and regulations, and the association's charter and bylaws, and provide for full protection to the Federal association. They shall be recorded and, among other protections, *shall provide specifically for full protection with respect to insurance, taxes, assessments, other governmental levies, maintenance, and repairs*. They may provide for an assignment of rents. *The association may pay taxes, assessments, insurance premiums, and other similar charges for protection of its interest in the security property . . . .*" (Italics added.)]

"Finally, it was and is the Board's intent to have . . . due-on-sale practices of Federal associations governed exclusively by Federal law. Therefore, . . . exercise of due-on-sale clauses by Federal associations shall be governed and controlled solely by § 545.6-11 and the Board's new Statement of Policy. Federal associations shall not be bound by or subject to any conflicting State law which imposes different . . . due-on-sale requirements, nor shall Federal associations attempt to . . . avoid the limitations on the exercise of due-on-sale clauses delineated in § 545.6-11(g) on the ground that such . . . avoidance of limitations is permissible under State law." (Preamble to 12 C.F.R. § 545.6-11, 41 Fed. Reg. 18287 (May 3, 1976).)]

[Thus it] is clear that the *Board* has manifested *its* unqualified intention that the adopted regulations and implementing policy relating to due-on-sale clauses shall occupy a preemptive position over conflicting state law provisions. [Italics added; fn. omitted.] Such expression of administrative intent was found controlling in *Glendale Fed. Sav. & Loan Ass'n v. Fox*, [*supra*, 459 F.Supp. at pp. 909-910)]. But we cannot equate the *Board's* expression of intent with the requisite *congressional* intent [italics added] since the ultimate question to be answered is "whether *Congress* has . . . ordained tht the state regulation shall yield." (*Florida Avocado Growers v. Paul, supra*, 373 U.S. at p. 146 [10 L.Ed.2d at p. 259]; italics added; [accord: *New York Dept. of Social Services v. Dublino, supra*, 413 U.S. at pp. 413-418 [37 L.Ed.2d at pp. 695-697]; *Katherine Gibbs Sch. (Inc.) v. F.T.C.* (2d Cir. 1979) 612 F.2d 658, 667, rehg. den. 628 F.2d 755].) [The decision whether to displace state law is a fundamental one going to the very fabric of federalism; thus, the decision is one to be made by the people through their elected representatives in Congress rather than by agencies or tribunals insulated from democratic pres-

sures. (Cf. *City of Milwaukee v. Illinois*, (April 28, 1981)* __ U.S. __ , __ , [__ S. Ct. ____]; *Katherine Gibbs Sch. (Inc.) v. F.T.C., supra.*)]

But despite the lack of express congressional design, federal law by implication may operate to the exclusion of state law "where compliance with both federal and state regulations is a physical impossibility" or where there is an "impossibility of dual compliance . . . resulting in . . . an inevitable collision between the two schemes of regulation, . . ." (*Florida Avocado Growers v. Paul, supra*, 373 U.S. at pp. 142-143 [10 L.Ed.2d at p. 257].)

In any early case a federal district court—confronted with the question whether a federally chartered savings and loan association was required to obtain a state certificate to transact business in the state—held in favor of federal preemption reasoning that: "The [Home Loan Bank] Board has adopted comprehensive rules and regulations concerning the powers and operations of every Federal savings and loan association from its cradle to its corporate grave." (*People, etc. v. Coast Federal Sav. & Loan Ass'n* (S.D.Cal. 1951) 98 F. Supp. 311, 316.) This broad declaration of lifetime supremacy has been cited with approval in a number of subsequent decisions uniformly holding that state law may not regulate [federal savings and loan associations] or otherwise interfere with . . . [their] internal affairs . . . . (See e.g. *Conference of Federal Sav. & Loan Ass'ns v. Stein* [*supra*] 604 F. 2d 1256, . . . [proceedings for credit discrimination]; *Kupiec v. Republic Federal Savings & Loan Ass'n* [*supra*] 512 F. 2d [at p.] 150 [use of membership records]; *Meyers v. Beverly Hills Federal Savings & Loan Ass'n* [*supra*] 499 F. 2d [at p.] 1147 [prepayment penalties]; *Rettig v. Arlington Hghts. Fed. Sav. & Loan Ass'n* [*supra*] 405 F. Supp. [at

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p.] 823 [fiduciary obligations of directors and officers]; *City Federal Savings & Loan Ass'n v. Crowley* (E.D. Wisc. 1975) 393 F. Supp. 644, 655 [fees received by directors and officers]; *Kaski v. First Fed. S & L Ass'n of Madison* (1976) 72 Wisc.2d 132 [240 N.W.2d 367] [interest rate escalation]; *Sears v. First Federal Savings and L. Ass'n of Chicago* (1971) 1 Ill. App.3d 621 [275 N.E.2d 300] [trust accounts for taxes and insurance]; see also *Derenco, Inc. v. Benj. Franklin Fed. Sav. & Loan Ass'n* [*supra*] 281 Or. 533 [577 P.2d 477], cert. den. 439 U.S. 1051 [58 L.Ed.2d 712, 99 S.Ct. 733].) [Bracketed descriptions in the original.]

Although that general proposition reflects a correct statement of law, we are not persuaded that existing state law pertaining to the exercise of due-on-sale clauses in any way infringes upon or is otherwise incompatible with the Board's regulation or . . . [control] of . . . federal savings and loan associations. (See *Holiday Acres v. Midwest Fed. Sav. & Loan Ass'n* (Apr. 3, 1981, No. 338) ___Minn. ___[___ N.W. 2d ___].) [Every substantive rule of state property and mortgage law has the potential for impinging upon federal savings and loan associations, but they are not thereby invalidated as "regulations" of the associations. As previously observed, the *Wellenkamp* rule is a substantive rule of California property and mortgage law. It is not directed at "regulating" and it is not a "regulation" of savings and loan associations as were the state law or state actions in *Conference of Federal Sav. & Loan Ass'ns v. Stein, supra,* 604 F.2d 1256, and *Glendale Fed. Sav. & Loan Ass'n v. Fox, supra,* 459 F.Supp. 903.]

[¶] The federal regulation merely authorizes and does not compel savings and loan associations to include a due-on-sale clause in their loan contracts and to exercise their rights thereunder. (*Holiday Acres v. Midwest Fed. Sav. & Loan Ass'n, supra.*) [P. 338.] As noted, California law . . . [per-

mits enforcement of] a due-on-sale clause only upon a showing that the lender's security will be either impaired or subjected to risk of default as a consequence of the transfer. But the federal loan association is not faced with physical impossibility in complying with the two regulatory schemes. Instead, the federal regulation leaves the rights and remedies of the parties intact under the terms of the loan contract. Thus, enforcement of the due-on-sale clause rests upon conventional contract and property principles under state law. (*Id.*, at p. 10.) There is no "inevitable collision" between the two regulations. (*Florida Avocado Growers v. Paul, supra*, at p. 143 [10 L.Ed.2d at p. 257] [cf. *Derenco, Inc. v. Benj. Franklin Fed. Sav. & Loan Ass'n, supra*, 577 P.2d at pp. 483-484].)

The Federal Home Loan Mortgage Corporation (FHLMC), appearing as amicus curiae, urges a finding of federal preemption based on a claim of need for national uniformity of loan practices and instruments[7] In response, we rely upon the persuasive language of the Minnesota Supreme Court: "If this national interest were indeed an important policy, it seems that the inclusion of such clauses would be mandated rather than permitted." (*Holiday Acres v. Midwest Fed. Sav. & Loan Ass'n, supra*, p. 338.) Nor, we think, would application of state law to the exercise of due-on-sale clauses interfere with the federal objectives embodied in the Home Owners' Loan Act. That legislation was enacted dur-

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[7]Briefly stated, the argument is made that due-on-sale clauses, by keeping the life of a mortgage relatively short, increase the lenders' yield and thereby promote the national interest by keeping overall interest rates down. Further, by providing a higher yield and a rapid return of capital to the lenders, due-on-sale clauses render the loans marketable in the secondary mortgage market, thereby attracting new funds to the mortgage market and, in turn, again keeping interest rates down. FHLMC, as purchaser of coventional mortgages, will purchase only those mortgages using the standardized FHLMC/FNMA loan instrument employed here.

ing a period of severe economic depression in order to assist financially distressed homeowners. It would be "unreasonable, and ironic, to hold now that the Congress intended [the act] to justify the removal of homeowners' protections under state law." (*Id.*, at p. 339.)

Our conclusion finds further support in the particular provisions of the deed of trust employed herein. The form of instrument is apparently one promulgated by the FHLMC itself; its use is a precondition to purchase of the mortgage by FHLMC. The trust instrument contains so-called "uniform" and "non-uniform" covenants. The uniform covenants are intended for nationwide use while the non-union covenants are tailored to particular state mortgage requirements. [Fn. omitted.] For example, the "nonuniform" covenants employed herein include California statutory requirements regarding notice (Civ. Code, § [2924b,]) reinstatement (Civ. Code, § [2924c]) and the furnishing of a statement of obligation (Civ. Code, § 2943.)

Included in the "uniform" covenants found in paragraph 15 [of the deed of trust] is the express proviso that: "[This form of deed of trust combines uniform covenants for national use and non-uniform covenants with limited variations *by jurisdiction . . . .*] *This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located.* In the event that any provision or clause of this Deed of Trust or Note *conflicts with applicable law* [italics added], such conflict shall not affect other provisions . . . ." (Italics added.) We believe such language expresses an unmistakable intention that state law shall govern the interpretation, validity and enforcement of the loan-security instrument.

[Defendants and amicus Federal Home Loan Mortgage Corporation contend that the law of a state includes all federal law the state is required to enforce, by preemption or otherwise, so that the provision in paragraph 15 that the

deed of trust shall be governed by the law of the jurisdiction in which the property is located has reference to both the state and federal law enforceable in that jurisdiction and that, inasmuch as the state law of California in respect to the exercise of due-on-sale clauses is preempted by the Board's regulation, the paragraph 15 provision is of no real significance in this case. Not so.

[Of course, reference to state law in some contexts may include reference to the federal law enforceable in the state, but to accept that interpretation here would entirely overlook the next sentence in paragraph 15 referring to a possible conflict of provisions or clauses of the deed of trust "with applicable law." If defendants and amicus were said to be correct that state law has been preempted by federal occupation of the field, there would be no "applicable law" other than the federal law and therefore no provision or clause of the deed of trust could be in conflict "with [the] applicable law." The same nonsensical result would flow from a holding that the "full protection" regulation preempts state law. Virtually every clause and provision in the deed of trust is for the "protection" of the association, and if state law were as a consequence preempted, there would be no "applicable law" with which any clause or provision could be in conflict.

[Thus, we are confirmed in our conclusion that paragraph 15 means just what it seems to say, that the law of California governs the validity and interpretation of deeds of trust on California property. Even if the matter were in doubt, the meaning of the provision would at least be ambiguous and uncertain, and the ambiguity and uncertainty would be construed against Fidelity Federal, the party responsible for it. (Civ. Code, § 1654; *Hibernia Sav. & Loan Soc. v. Lauffer* (1940) 41 Cal.App.2d 725, 731 [107 Cal.Rptr. 494]; *Bituminous Casualty Corporation v. Lynn* (6th Cir. 1974) 503

F.2d 636, 640-641; *Kenneth Reed Construction Corp. v. United States* (1973) 475 F.2d 583, 588 [201 Ct.Cl. 282].)]

In conclusion, we hold that California law is not preempted by virtue of the relevant federal regulation. . . .

C. *DISPOSITION*

As to the Moore case (Super. Ct. No. 306349), the judgment is reversed with directions to render summary judgment in favor of the plaintiffs.

II—The Whitcombe Case

A. *THE FACTS*

On July 17, 1972, Fidelity Federal made a loan of $29,200 to Carter and Irene R. Wood secured by a deed of trust on their residential real property at 7392 Natal Drive, Westminster, in the State of California. The deed of trust contained a due-on-sale clause purportedly giving Fidelity Federal the right to declare the unpaid balance of the loan immediately due and payable in the event the property was sold or otherwise transferred or conveyed by the borrowers. The deed of trust also contained a provision stating that the deed of trust "shall be governed by the law of the jurisdiction in which the Property is located." (See full text of the provision set forth in bracketed fn. 1, *ante*.)

On November 9, 1978, the Woods sold and, by grant deed, transferred the property to plaintiff John D. Whitcombe.

Having learned that the property had been sold and conveyed to Whitcombe, Fidelity Federal gave notice of its intention to exercise the due-on-sale clause in the deed of trust and on December 29, 1978, caused to be recorded a notice of default and election to sell under the deed of trust. Whereupon, Whitcombe instituted suit.

B. *FEDERAL PREEMPTION*

The principles discussed under the heading "Federal Preemption" in the Moore case are fully applicable to this case. In fact, they apply a fortiori here, because the deed of trust in this case was executed July 17, 1972, years before the Board's promulgation of its due-on-sale regulation on June 8, 1976, which expressly indicates that it is not applicable to security instruments executed prior to that date. As indicated in our discussion of the preemption issue in the Moore case, the contention that state law was theretofore preempted by the "full protection" regulation is devoid of merit.

Accordingly, we hereby incorporate as though fully set forth our discussion of the federal preemption issue in section IB of this opinion, and we conclude that the *Wellenkamp* rule is applicable.

C. *DISPOSITION*

As to the Whitcombe case (Super. Ct. No. 308527), the judgment is reversed with directions to render summary judgment in favor of the plaintiff.

III—The de la Cuesta Case

A. *FACTS*

On January 18, 1971, Fidelity Federal made a loan of $105,000 to Howard G. and Ellen Mae Trabant secured by a deed of trust on what we are told is commercial property at 19462-19488 Beach Boulevard, Huntington Beach, in the State of California. The deed of trust contained a due-on-sale clause purportedly giving Fidelity Federal the right to declare the unpaid balance of the loan immediately due and payable in the event the property was sold or otherwise transferred or conveyed by the borrowers.

On October 25, 1977, the Trabants sold and, by grant deed, transferred the property to plaintiffs Reginald de la Cuesta and Margaret de la Cuesta.

Having learned that the property had been sold and conveyed to the de la Cuestas, Fidelity Federal gave notice of its intention to exercise the due-on-sale clause in the deed of trust and on December 7, 1978, caused to be recorded a notice of default and election to sell under the deed of trust. Whereupon, the de la Cuestas instituted this action.

B. *FEDERAL PREEMPTION*

The principles set forth in our discussion of federal preemption in the Moore case are fully applicable to this case also. In fact, again, they apply a fortiori in this case because the Trabant deed of trust was executed January 18, 1971, many years prior to promulgation by the Board of its due-on-sale regulation on June 8, 1976, and, as indicated in our discussion in the Moore case, the contention that state law was theretofore preempted by the "full protection" regulation is devoid of merit.

We recognize that the deed of trust here involved does not contain a provision such as that found in the other two deeds of trust to the effect that it shall be governed by the law of the jurisdiction in which the property is situated. However, our conclusion in the Moore case was not based so much on an agreement between the parties for the application of state law as on the conclusion that the general use of a provision containing such language by federal savings and loan associations with the approval of the Board persuasively evidences a recognition by the Board and federal savings and loan associations that state law would govern the interpretation, validity and enforcement of security instruments. Thus, the absence of the special provision in

the particular trust deed, here, is of no great significance to our resolution of the preemption issue.

Accordingly, with the exception of those portions relating directly to the special provision in the Moore deed of trust, we hereby incorporate as though fully set forth our discussion of the preemption issue under section IB of this opinion and conclude that application of the state law has not been federally preempted.

C. *THE COMMERCIAL PROPERTY PROBLEM*

There is nothing in the pleadings and virtually nothing in the declarations in support of the motions for summary judgment that discloses the precise nature of the property encumbered by the deed of trust in this case. One document indicates that it is "commercial" and "income producing." Otherwise we are in the dark.

Defendants assert that there are a number of differences between owner-occupied residential property and income-producing, commercial property from which defendants conclude that the rule in *Wellenkamp* ought not to be applied to a deed of trust on commercial property. They assert that owners of commercial property have the ability to raise rents or prices of manufactured goods; that an owner of commercial property is less likely than a homeowner to be compelled to transfer the property at a time of "tight" money; that buyers of commercial property are not normally compelled to purchase at a time of "tight" money; and that commercial buyers carefully weigh business and tax advantages, whereas residential buyers do not.

We are aware, of course, that in *Holiday Acres v. Midwest Fed. Sav. & Loan Ass'n, supra,* ____ N.W.2d ____ at page ____ , the Minnesota Supreme Court was impressed with some such differences in concluding that automatic

exercise of a due-on-sale clause in a security instrument used to finance residential investment property was not impermissible. However, the declarations in support of the motions for summary judgment in the case at bench contain no competent evidence to establish the factual distinctions asserted by defendants, and we are unable and unwilling to take judicial notice of them. Moreover, it seems to us that at least the last of the differences asserted by defendants argues as well for application of the *Wellenkamp* rule as against its application.

Defendants also call to our attention that the property involved in *Wellenkamp* was apparently not commercial property and that the court in the *Wellenkamp* decision mentioned the preferred status under California law of a homeowner's equity. (21 Cal. 3d at p. 950, fn. 6.) That is true, but the *Wellenkamp* court did not even specifically mention that the property in that case was residential, much less differentiate in its language between commercial and residential properties. The court consistently used generic phraseology such as "a parcel of real property," "real property" and "real estate loans." (See, e.g., 21 Cal.3d at pp. 946, 947, 949, 950, 951, 953 and 954.)

The basis for decision was that exercise of a due-on-sale clause in the absence of any threat of impairment to the security or risk of default resulting from the sale or transfer constitutes an unreasonable restraint on alienation. Going to the heart of the decision was the following language of the court: "Economic risks such as those caused by an inflationary economy are among the general risks inherent in every lending transaction. They are neither unforeseeable nor unforeseen. Lenders who provide funds for long-term real estate loans should and do, as a matter of business necessity, take into account their projections of future economic conditions when they initially determine the rate

of payment and the interest on these long-term loans. [Citation.] Unfortunately, these projections occasionally prove to be inaccurate. We believe, however, that it would be unjust to place the burden of the lender's mistaken economic projections on property owners exercising their right to freely alienate their property through the automatic enforcement of a due-on-sale clause by the lender." (*Id.*, at pp. 952-953, fn. omitted.) There is no suggestion in the court's language that its reasoning would have been different had the encumbered property been commercial rather than residential property. We also note that *Tucker v. Lassen Sav. & Loan Assn.* (1974) 12 Cal.3d 629 [116 Cal.Rptr. 633, 526 P.2d 1169], upon which the *Wellenkamp* court heavily relied, involved a house used as residential investment property. (*Id.*, at p. 633.) In fine, if there are circumstances in which the *Wellenkamp* rule should not be applied because of the commercial nature of the encumbered property, they have not been made to appear in this case, and we see no reason the *Wellenkamp* rule should be inapplicable in the circumstances here shown.

D. *DISPOSITION*

As to the de la Cuesta case (Super.Ct.No. 286474) the judgment is reversed with directions to the trial court to enter summary judgment in favor of the plaintiffs.

McDaniel, J., and Morris, J., concurred.

Court of Appeal Modification & Denial of Rehearing.

Court of Appeal, Fourth Appellate District, Division Two, State of California. Filed July 22, 1981, 4 Civil 23253.

Reginald D. de la Cuesta, et al., Plaintiffs and Appellants, v. Fidelity Federal Savings & Loan Association, et al., Defendants and Respondents, (Super.Ct.No. 286474). Alphonso Moore, et al., Plaintiffs and Appellants, v. Fidelity Federal Savings & Loan Association, et al., Defendants and Respondents. (Super.Ct.No. 306349). John D. Whitcombe, Plaintiff and Appellant, v. Fidelity Federal Savings & Loan Association, et al., Defendants and Respondents. (Super.Ct.No. 308527).

The opinion heretofore filed on July 2, 1981, is modified as follows. In line 4 of footnote 5 on page 11 immediately following the citation (12 U.S.C. § 1464(a)(1)) delete the comma and the word "but" and insert a semicolon and the words "however, associations which were formerly state chartered banks" before the words "are not exempt . . . ."

Except as thus modified, the original opinion filed July 2, 1981 remains unchanged and the judgment is unaffected.

The petition for rehearing is denied.

CERTIFIED FOR PUBLICATION.

Kaufman
Acting P.J.

I concur:

McDaniel, J.

Supreme Court Denial of Hearing.

Clerk's Office, Supreme Court, 4250 State Building, San Francisco, California 94102, Aug. 26, 1981.

I have this day filed Order, Hearing Denied.

In re: 4/cv., No. 23253, de la Cuesta, et al, vs., Fidelity Federal.

Respectfully, Clerk

Trial Court Order Granting Summary Judgment.

Superior Court of the State of California, for the County of Orange.

Court convened at .... M., October 19, 1979, present Hon. E. J. Wallin, Judge; L. Tanner, Deputy Clerk; None, Deputy Sheriff; None, Reporter; and the following proceedings were had:

28-64-74 DE LA CUESTA vs. FIDELITY FEDERAL SAVINGS AND LOAN,

30-63-49 MOORE vs. FIDELITY FEDERAL SAVINGS AND LOAN,

30-85-27 WHITCOMBE vs. FIDELITY FEDERAL SAVINGS AND LOAN

MOTION OF DEFENDANTS FOR SUMMARY JUDGMENT

MOTION OF PLAINTIFF FOR SUMMARY JUDGMENT

Motion of defendants for summary judgment is granted in each case. Motion of Plaintiff for summary judgment is denied in each case. The Court believes the federal government has totally occupied the subject of regulation of Federal Savings and Loans. Since a due on sale clause is permitted for federal savings and loans the Supreme Court's decision in *Wellenkamp v. Bank of America* 21 Cal. 3d 943 (1978), cannot be extended to savings and loans. Andrew Katz to give notice. ENTERED: 10-19-79.

Trial Court Judgment.

In the Superior Court of the State of California, for the County of Orange

Reginald D. de la Cuesta, and Margaret de la Cuesta, Plaintiffs, vs. Fidelity Federal Savings and Loan Association, et al., Defendants. Alphonso Moore and Alice Moore, Plaintiffs, vs. Fidelity Federal Savings and Loan Association, et al., Defendants. John D. Whitcombe, Plaintiff, vs. Fidelity Federal Savings and Loan Association, et al., Defendants. Case Nos. 28-64-74, 30-63-49, 30-85-27.

Filed December 10, 1979.

This consolidated matter was heard by the Court upon motion of defendants Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation for summary judgment, or in the alternative, judgment on the pleadings, and the motion of plaintiffs Reginald D. de la Cuesta, et al. for summary judgment. At the hearing on the motions held before this Court on June 19, 1979, Andrew E. Katz of Hahn Cazier & Leff and Walter L. Blackwell, III, Esq. appeared for defendants, and Timothy L. Newlove of Fred Crane, A Professional Corporation, appeared for plaintiffs. Following extended argument and upon full consideration of all evidence, pleadings, and memoranda filed by the parties, the Court entered its Minute Order dated October 19, 1979 granting the motion for summary judgment of defendants and denying the motion for summary judgment of plaintiffs.

IT IS HEREBY ORDERED AND ADJUDGED that the actions of plaintiffs are without merit, plaintiffs shall take

nothing by their respective actions, and defendants are entitled to judgment in their favor with costs in each action.

DATED: Dec. 10, 1979.

/s/ EDWARD J. WALLIN
EDWARD J. WALLIN
Judge of the Superior Court

APPROVED AS TO FORM:
FRED CRANE, A Professional Corporation

/s/ By Timothy L. Newlove
Timothy L. Newlove

Notice of Appeal.

(Filed October 14, 1981)

In the Court of Appeal of the State of California, Fourth Appellate District, Division Two

Reginald D. de la Cuesta, et al., vs. Fidelity Federal Savings & Loan Association, et al., Alphonso Moore, et al., vs., Fidelity Federal Savings & Loan Association, et al., John D. Whitcombe, vs., Fidelity Federal Savings & Loan Association, et al. 4th Civil No. 23253.

Appeal From the Superior Court of Orange County, Hon. Edward J. Wallin, Judge.

Notice of Appeal to the Supreme Court of the United States.

Notice is hereby given that Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation ("Fidelity Federal"), appellees in the above-entitled consolidated matters, appeal to the Supreme Court of the United States from the judgment dated July 2, 1981 of the Court of Appeal, Fourth Appellate District, State of California, Division Two ("Court of Appeal") reversing the judgment of the trial court in favor of Fidelity Federal, which judgment of the Court of Appeal became final for purposes of appeal to the Supreme Court of the United States on August 26, 1981, the date upon which the Supreme Court of the State of California denied hearing on Fidelity Federal's Petition for Hearing.

This appeal is taken pursuant to 28 U.S.C. § 1257(2).

Dated: October 13, 1981

HAHN CAZIER & LEFF
ANDREW E. KATZ
STEVEN G. POLARD
WALTER L. BLACKWELL, III
By /s/ Andrew E. Katz
Andrew E. Katz
Attorneys for FIDELITY FEDERAL SAVING AND LOAN ASSOCIATION AND GATEWAY MORTGAGE CORPORATION

Proof of Service by Mail.

I, Andrew E. Katz, attorney for defendants and appellants herein, and a member of the Bar of the Supreme Court of the United States, hereby certify and declare that I am over the age of 18 years and not a party to the within cause. My business address is 555 South Flower Street, Forty-Second Floor, Los Angeles, California 90071; that on October 14, 1981, I served a copy of the foregoing Notice of Appeal to the Supreme Court of the United States upon all the required parties, or to their counsel of record, in said cause by placing a true copy thereof enclosed in a sealed envelope, with postage thereon fully prepaid, in the United States Post Office mail at Los Angeles, California, addressed as follows:

Fred Crane, Esq.
A Professional Corporation
3576 Arlington Avenue
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Riverside, California 92506

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Arthur C. de Goede, Assistant Attorney General
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John W. Dumas, Esq.
600 Civic Center Drive West
Suite 201
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The Honorable Edward J. Wallin
Orange County Superior Court
700 Civic Center Drive, West
Santa Ana, California 92701

The Honorable Marcus M. Kaufman
The Honorable F. Douglas McDaniel
The Honorable Margaret J. Morris
Justices of the Court of Appeal
Fourth Appellate District
Division Two
640 State Building
303 West 3rd Street
San Bernardino, California 92401

I further certify that all parties required to be served have been served.

This declaration was executed on October 14, 1981, at Los Angeles, California.

I declare under penalty of perjury that the foregoing is true and correct.

/s/ Andrew E. Katz
Andrew E. Katz

U.S. Constitution Art. VI cl. 2

ARTICLE VI.

Clause 2. Supreme Law of Land

This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

12 U.S.C. § 1464(a)

§ 1464. Thrift Institutions

Organizations authorized;
Federal mutual savings bank activities

(a)(1) In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal Savings and Loan Associations", or "Federal mutual savings banks" (but only in the case of institutions which, prior to conversion, were State mutual savings banks located in States which authorize the chartering of State mutual savings banks, provided such conversion is not in contravention of State law), and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States. An association which was formerly organized as a savings bank under State law may not convert from the mutual to the stock form of ownership. An association which was formerly organized as a savings bank under State law may not convert from the mutual to the stock form of ownership. An association which was formally organized as a savings bank under State law may, to the extent authorized by the Board, continue to carry on any activities it was engaged in on December 31, 1977, and to retain or make any investments of a type it held on that date, except that its equity, corporate bond, and consumer loan investments may not exceed the average ratio of such investments to total assets for the five-year period immediately preceding the filing of an application for conversion and such an association which was formerly organized as a savings bank

under State law shall only be permitted to establish branch offices and other facilities in accordance with the limitations imposed by State law controlling applications of a savings bank organized under such State law, provided that such an association: (A) shall be exempt from any numerical limitations of State law on the establishment of branch offices and other facilities, and (B) may, in any case, subject to the approval of the Board, establish branch offices and other facilities in its own Standard Metropolitan Statistical Area, its own county or within thirty-five miles of its home office, but only in its State of domicile. An association which was formerly organized as a savings bank under State law shall be subject to the requirements of State law (including any regulations promulgated thereunder and any sanction for the violation of any such law or regulation) in effect at the time of conversion, in the State of its original charter —

(A) pertaining to discrimination in the extension of home mortgage loans or adjustment in the terms of mortgage instruments based on neighborhood or geographical area,

(B) pertaining to requirements imposed under the Consumer Credit Protection Act,

if the Board determines that State law and regulations impose more stringent requirements than Federal law and regulations.

(2) A Federal mutual savings bank may make commercial, corporate, and business loans except that —

(A) not more than 5 per centum of the assets of such a bank may be so loaned; and

(B) such loans may only be made within the State where the bank is located or within 75 miles of the bank's home office.

(3) In addition to the authority conferred by paragraph (1), Federal mutual savings bank may accept demand deposits in connection with a commercial, corporate, or business loan relationship.

12 C.F.R. § 545.8-3 (f) & (g)

(f) *Due-on-sale clauses.* An association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. Except as provided in paragraph (g) of this section with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by that contract.

(g) *Limitations on the exercise of due-on-sale clauses.* With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association: (1) Shall not exercise a due-on-sale clause because of (i) creation of a lien or other encumbrance subordinate to the association's security instrument, (ii) creation of a purchase money security interest for household appliances; (iii) transfer by devise, descent, or operation of law on the death of a joint tenant; or (iv) granting of a leasehold interest of three years or less not containing an option to purchase; (2) shall not impose a prepayment charge or equivalent fee for acceleration of the loan by exercise of a due-on-sale clause; and (3) waives its option to exercise a due-on-sale clause as to a specific transfer if, before the transfer, the association and the person to whom the property is to be sold or transferred (the existing borrower's successor in interest) agree in writing that the person's credit is satisfactory to the association and that

interest on sums secured by the association's security interest will be payable at a rate the association shall request. Upon such agreement and resultant waiver the association shall release the existing borrower from all obligations under the loan instruments, and the association is deemed to have made a new loan to the existing borrower's successor in interest.

12 C.F.R. § 556.9(f)

§ 556.9 Imposition of late charges and due-on-sale clauses.

* * * * *

(f) *Due-on-sale policy and Federal preemption.* (1) Federal associations are obliged to take reasonable precautions to protect themselves against the economic risks associated with mortgage lending, including the risk that the cost of lendable funds will exceed the yield from existing mortgage loans, and that sharply rising interest rates will reduce substantially the value of existing mortgage assets. In this connection, the Board has determined that the due-on-sale clause normally is a valuable and often an indispensable source of protection for the financial soundness of Federal associations and for their continued ability to fund new home loan commitments. Consequently, the Board for many years has authorized due-on-sale clauses for use by Federal associations. However, because the Board desires to afford associations the flexibility to accommodate special situations and circumstances, § 545.8-3(f) of this Subchapter by its terms merely authorizes rather than compels the inclusion and exercise of due-on-sale clauses in mortgage loans.

(2) Paragraph (f) of § 545.8-3 confirms the continuing authority of Federal associations to include due-on-sale clauses in their mortgage loan contracts and to exercise such clauses, subject only to the express limitations contained in § 545.8-3(g). Due-on-sale practices of Federal associations shall be governed exclusively by the Board's regulations, in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise (including, but not confined to, state law prohibitions against restraints on alienation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers).

Federal Home Loan Bank Board
Resolution No. 76-296

Date: April 28, 1976

TITLE 12 — BANKS AND BANKING
Chapter V — Federal Home Loan Bank Board
Subchapter C — Federal Savings and Loan System
Part 545 — Operations
Part 556 — Statements of Policy
AMENDMENTS RELATING TO LATE CHARGES AND DUE-ON-SALE CLAUSES

Summary

The following summary of the amendments adopted by this Resolution is provided for the reader's convenience and is subject to the full explanation in the following preamble and to the specific provisions of the amendments.

I. Present Situation

The Federal Home Loan Bank Board permits Federal associations, if authorized by their loan contracts . . . to declare the loan immediately due and payable if the borrower sells or transfers the real property securing the loan without the consent of the association.

II. Final Amendment

A. A Federal association continues to be empowered to include, as a matter of contract between it and the borrower, provisions in its loan contracts for . . . the acceleration of the maturity of the loan, at the option of the association, if the borrower sells or transfers the loan security property without prior written consent of the association.

* * *

C. Restrictions are placed on exercise of acceleration (due-on-sale) clauses contained in future loan contracts secured by borrower-occupied homes.

III. Differences from Proposal

* * *

B. Due-on-sale Clauses

A new Statement of Policy is issued regarding exercise of due-on-sale clauses and loan assumptions.

C. *Effective Date*

Effective date is 7/31/76; proposal specified 5/31/76

By Resolution No. 76-100 of February 6, 1976, the Federal Home Loan Bank Board proposed to amend § 545.6-11 of the Rules and Regulations for the Federal Savings and Loan System (12 CFR 545.6-11) for the purposes of clarifying and limiting the authority of Federal savings and loan associations in the area of late charges and due-on-sale clauses. Notice of such proposed rulemaking was duly published in the *Federal Register* on February 12, 1976 (41 F.R. 6283-6287), with an invitation for interested persons to submit comments by March 22, 1976. On the basis of all relevant material presented by interested persons and otherwise available, the Board hereby adopts the changes as proposed, with modifications discussed below.

* * *

Paragraphs (f) and (g) of § 545.6-11, relating to Federal associations' authority regarding due-on-sale clauses, are adopted substantially as proposed, with some portions rewritten or re-numbered for clarification purposes only. The effective date of the limitations is July 31, 1976.

A new Statement of Policy clarifying and interpreting the Board's policies pertaining to late charges and due-on-sale clauses is adopted by the Board at § 556.9. Paragraph (a) expresses the Board's view that all contract terms affecting the borrower should be fully disclosed no later than the time

of loan closing. Paragraph (b)(1) states that the Board disfavors the practice of imposing prepayment charges upon exercise of due-on-sale-clauses with regard to loans made prior to August 1, 1976, on the security of borrower-occupied homes, and urges associations to curtail this practice in connection with such earlier loans in the absence of extraordinary circumstances. Paragraph (b)(2) describes considerations relevant to imposition of late charges with regard to loans made prior to August 1, 1976. Paragraph (c) expresses the Board's view that there may be circumstances other than those described in § 545.6-11(g)(1) where an association should consider waiver of its acceleration option. Paragraph (d) states the Board's expectation that, in transactions covered by the loan assumption provision of § 545.6-11(g)(3), associations should not increase interest rates to rates in excess of current-market interest rates for comparable loans made by the associations applying their normal underwriting standards. New paragraph (e) states the Board's interpretation with respect to maintenance of mortgage insurance in connection with the requirements of paragraph 545.6-11(g)(3).

Finally, it was and is the Board's intent to have late charges and due-on-sale practices of Federal associations governed exclusively by Federal law. Therefore, charging of late charges and exercise of due-on-sale clauses by Federal associations shall be governed and controlled solely by § 545.6-11 and the Board's new Statement of Policy. Federal associations shall not be bound by or subject to any conflicting State law which imposes different late charges or due-on-sale requirements, nor shall Federal associations attempt to impose a higher late charge than permitted in § 545.6-11(e) or avoid the limitations on the exercise of due-on-sale clauses delineated in § 545.6-11(g) on the

ground that such higher charge or avoidance of limitations is permissible under State law.

Accordingly, the Board hereby revises § 545.6-11 and adds § 556.9 to read as set forth below, effective June 8, 1976.

1. Part 545 — Operations

§ 545.6-11 *Loan contract.*

* * *

(f) *Due-on-sale clauses.* A Federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. Except as provided in paragraph (g) of this section with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by an association of such an acceleration option (hereafter called a due-on-sale clause) shall be governed exclusively by the terms of the contract between the association and the borrower, and all rights and remedies of the association and borrower thereto shall be fixed and governed by said contract.

(g) *Limitations on the Exercise of due-on-sale clauses.*

(1) With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association may not exercise a due-on-sale clause based on any of the following:

(i) creation of a lien or other encumbrance subordinate to the association's security instrument;

(ii) creation of a purchase money security interest for household appliances;

(iii) transfer by devise, descent, or by operation of law upon the death of a joint tenant; or

(iv) grant of any leasehold interest of three years or less not containing an option to purchase.

(2) With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, no Federal association shall impose a prepayment charge or equivalent fee in connection with the acceleration of the loan pursuant to the exercise of a due-on-sale clause.

(3) With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association shall have waived its option to exercise a due-on-sale clause as to a specific transfer if, prior to that transfer, the association and the person to whom the property is to be sold or transferred (the existing borrower's successor in interest) reach written agreement that the credit of such person is satisfactory to the association and that the interest payable to the association on sums secured by its security instrument shall be at such rate as the association shall request. Upon such written agreement and resultant waiver, the association shall release such existing borrower from all obligations under the loan instruments, and for purposes of § 541.14(a) the association shall be deemed to have made a new loan to such existing borrower's successor in interest.

2. Part 556 — Statements of Policy

§ 556.9 *Imposition of late charges and due-on-sale clauses.*

(a) The Board allows Federal savings and loan associations certain authority to incorporate into loan instruments provisions for imposition of late charges, prepayment

charges, and exercise of acceleration clauses, including due-on-sale clauses. The Board expects associations to adopt procedures sufficient to ensure that, no later than the time of loan closing, the rights and obligations of the contracting parties under these provisions are fully and specifically disclosed to borrowers.

(b)(1) Imposition of a prepayment charge upon exercise of a due-on-sale clause is prohibited pursuant to § 545.6-11(g)(2) of this subchapter only with regard to loans made upon borrower-occupied homes after July 31, 1976; however, the Board looks with disfavor upon such practice respecting all loans made on the security of borrower-occupied homes, and believes that associations should abstain therefrom in connection with such loans made before such date, except in extraordinary circumstances.

* * *

(c) Paragraph 545.6-11(g)(1) of this subchapter prohibits with respect to borrower-occupied-home loans made after July 31, 1976, exercise of due-on-sale clauses to accelerate the loan based on creation of junior liens, certain purchase-money security interests, transfers by devise, descent, or by operation of law upon the death of a joint tenant, and certain short-term leasehold interests. However, the Board believes that there may be other situations respecting loans made on the security of borrower-occupied homes in which, depending on the circumstances of the individual case, it will be appropriate for Federal associations to waive their contractual right to accelerate. These situations include transfers of title to members of the borrower's immediate family, including a former spouse in connection with a divorce, who occupy or will occupy the property (to the extent not covered by paragraph 545.6-11(g)(1)(iii)). In addition, associations should consider waiving any right to

require an increase in interest rate pursuant to a due-on-sale clause in cases of extreme hardship to the existing borrower.

(d) Paragraph 545.6-11(g)(3) of this subchapter authorizes Federal associations to increase the interest rate as a condition of loan assumption. However, the Board expects that no association will request an increase in the interest rate to a rate in excess of the then prevailing rate on comparable new loans made by the association applying its normal underwriting standards.

(e) The Board does not interpret paragraph 545.6-11(g)(3) of this subchapter to preclude an association from requiring, as a condition to an assumption, the continued maintenance of mortgage insurance by the existing borrower's successor in interest, whether by endorsement of a policy previously procured by the existing borrower or by entrance into a new contract of insurance.

(Sec. 5, 48 Stat. 132, as amended; 12 U.S.C. § 1464. Reorg. Plan No. 3 of 1947, 12 F.R. 4981, 3 CFR, 1943-46 Comp., p. 1071)

By the Federal Home Loan Bank Board

/s/ J. J. Finn
J. J. Finn
Secretary

California Civil Code § 711.

§ 711. Conditions in restraint of alienation

CONDITIONS RESTRAINING ALIENATION VOID. Conditions restraining alienation, when repugnant to the interest created, are void. (Enacted 1872.)

Joint Appendix

Office - Supreme Court, U.S.
FILED
FEB 25 1982
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CLERK

No. 81-750

IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants.

vs.

REGINALD D. de la CUESTA, *et al.*,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants.

vs.

ALPHONSO MOORE, *et al.*,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants.

vs.

JOHN D. WHITCOMBE,

Appellee.

Appeal from the California Court of Appeal, Fourth Appellate District.

JOINT APPENDIX.

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APPEAL DOCKETED OCTOBER 20, 1981.
PROBABLE JURISDICTION NOTED JANUARY 25, 1982.

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*Jurisdictional Statement Appendix

Chronological List of Relevant Docket Entries.

March 16, 1978	Plaintiffs de la Cuestas' Complaint for Declaratory Relief, Injunction and Slander of Title, filed in the Superior Court of California for the County of Orange.
July 6, 1978	Answer of Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation (hereinafter collectively "Fidelity Federal") to Complaint of the de la Cuestas filed.
January 30, 1979	Plaintiff Moore's Complaint for Declaratory Relief, Injunction and Slander of Title filed.
March 5, 1979	Plaintiff Whitcombe's Complaint for Declaratory Relief, Injunction and Slander of Title filed.
April 2, 1979	Answer of Fidelity Federal to Moore's Complaint filed.
April 17, 1979	Fidelity Federal's Notice of Motion and Motion for Summary Judgment or in the Alternative Judgment on the Pleadings filed.
April 17, 1979	Fidelity Federal's Memorandum of Points and Authorities, Declaration of Wallace E. Bowen and Exhibits in Support of its Motions for Summary Judgment or Judgment on the Pleadings filed.
April 23, 1979	Minute Order of the Superior Court of the State of California in and for the County of Orange Ordering Consolidation of de la Cuesta, Moore and Whitcombe as per Written Stipulation.

April 26, 1979	Answer of Fidelity Federal to Whitcombe's Complaint filed.
May 29, 1979	Plaintiffs' Notice of Cross-motion and Cross-motion for Summary Judgment in Opposition to Defendants' Motions for Summary Judgment and Judgment on the Pleadings; Memorandum of Points and Authorities and Exhibits in Support Thereof filed.
June 13, 1979	Defendants' Memorandum of Points and Authorities in Opposition to Plaintiffs' Cross-motion for Summary Judgment in Reply to Plaintiffs' Opposition to Fidelity Federal's Motion for Summary Judgment or in the Alternative Judgment on the Pleadings, received; filed: October 22, 1979.
June 16, 1979	Plaintiffs' Reply to Defendants' Opposition to Plaintiffs Cross-motion for Summary Judgment received; filed: June 19, 1979.
June 21, 1979	Plaintiffs' Post-hearing Memorandum received; filed: October 22, 1979.
August 24, 1979	Plaintiffs' Request for Judicial Notice received; filed: October 22, 1979.
September 7, 1979	Plaintiffs' Supplemental Points and Authorities re: Plaintiffs' Request for Judicial Notice received; filed: October 22, 1979.
September 13, 1979	Reply of Defendants to Plaintiffs' Request that Judicial Notice be Taken, and Counter-Request that Judicial Notice be Taken, received; filed: October 22, 1979.

October 9, 1979	Superior Court of California, County of Orange, Minute Order, granting Defendants' Motion for Summary Judgment and Denying Plaintiffs' Motion filed.
November 7, 1979	Plaintiffs' Notice of Motion and Motion for New Trial, Points and Authorities, and Declaration of Timothy L. Newlove in Support Thereof filed.
December 5, 1979	Defendants' Points and Authorities in Opposition to Plaintiffs' Motion for New Trial received; filed: December 16, 1979.
December 10, 1979	Superior Court of California, County of Orange, Law and Motion Minute Order Denying Plaintiffs' Motion for New Trial filed.
December 10, 1979	Judgment as to all three consolidated cases filed; and then entered December 10, 1979.
December 13, 1979	Defendants' Notice of Entry of Judgment filed.
February 11, 1980	Plaintiffs' Notice of Appeal filed.
July 2, 1981	Opinion of the Court of Appeal, Fourth Appellate District, Division Two, State of California, filed.
July 22, 1981	Modification of Opinion on Denial of Rehearing, Court of Appeal, Fourth Appellate District, Division Two, State of California, filed.
August 26, 1981	California Supreme Court Order Denying Hearing, filed.

October 14, 1981	Notice of Appeal to the Supreme Court of the United States filed in the Court of Appeal of the State of California, Fourth Appellate District, Division Two.

Complaint for Declaratory Relief, Injunction, and Slander of Title.

In the Superior Court of California, County of Orange.

Reginald D. de la CUESTA and Margaret de la CUESTA, Plaintiffs, vs. Fidelity Federal Savings and Loan Association, a federally chartered association, Gateway Mortgage Corporation, a California corporation, and Does I through X, inclusive, Defendants. Case No. 28-64-74.

Filed: March 16, 1978.

Plaintiffs allege:

FIRST CAUSE OF ACTION

1. At all times herein mentioned, defendant FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION (hereinatter referred to as "Fidelity Federal") was and now is a federally chartered savings and loan association with its principal place of business in the City of Glendale, County of Los Angeles, State of California.

2. Plaintiffs are informed and believe, and on that basis allege, that defendant GATEWAY MORTGAGE CORPORATION is the trustee under that certain deed of trust, attached hereto as Exhibit "A" and more fully described in paragraph 5 herein.

3. The true names or capacities, whether individual, corporate, associate, or otherwise, of the defendants named herein as DOES 1 through 10, inclusive, are unknown to plaintiffs who therefore sue said defendants by such fictitious names, and plaintiffs will amend this complaint to show their true names and capacities when the same have been ascertained.

4. On or about January 18, 1971, HOWARD G. TRABANT and ELLEN MAE TRABANT, husband and wife (collectively referred to herein as ("Trabant")), made, ex-

ecuted and delivered to defendant FIDELITY FEDERAL a promissory note in the amount of $105,000.00.

5. To secure payment of the principal sum and interest as provided in the note and as part of the same transaction, TRABANT executed and delivered to defendant FIDELITY FEDERAL that certain deed of trust dated January 18, 1971, by the terms of which TRABANT, as trustor, conveyed to GATEWAY MORTGAGE CORPORATION, a California corporation, as trustee of the subject real property, located at 19462-19488 Beach Boulevard, Huntington Beach, Orange County, California. A further description of said property is set forth in said deed of trust attached hereto as Exhibit "A" and made a part hereof by reference. Said deed of trust has remained in effect up to and including the date of filing this complaint.

6. On or about October 25, 1977, escrow closed on a transaction of purchase and sale of the real property described above. Vendor was TRABANT and vendees were the plaintiffs herein. A grant deed was recorded on the same day, as Instrument No. 32005 of Orange County Records, a copy of which is attached hereto as Exhibit "B" and made a part hereof by reference.

7. On or about December 7, 1977, defendant FIDELITY FEDERAL, for reason of the aforesaid transfer of title to plaintiffs herein, caused to be executed and delivered to plaintiffs a Notice of Default and Election to Sell under Deed of Trust, which is the subject of this litigation. A copy of said Notice is attached hereto as Exhibit "C" and made a part hereof by reference.

8. The subject deed of trust incorporates by reference the following alienation clause:

> "should Trustor or any successor in interest to Trustor in such property sell, sell under contract of sale, lease

with option to purchase, convey, transfer, encumber, or alienate said property, or any part thereof, or any interest therein, or be divested of his title or any interest therein in any manner or way, whether voluntary or involuntary, Beneficiary shall have the right, at his option, to declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in any note or written agreement evidencing the same, immediately due and payable."

Upon said clause does defendant FIDELITY FEDERAL base its Notice of Default. Defendant declares itself to be entitled thereby to automatically enforce the provisions of said clause, without regard to reason or justification.

9. Plaintiffs herein represent no threat to defendant's security interest and have not impaired or jeopardized defendant's security interest in any manner and no reasonable probability exists that defendant FIDELITY FEDERAL'S security interest has been or will be jeopardized to any degree by reason of said transfer of title to the plaintiffs herein.

10. Plaintiffs are informed and believe, and on that basis allege, that defendant's actions in enforcing the "due-on-sale" clause contained in said trust deed were not taken in concern for defendant's security interest in said real property or in concern for the creditworthiness of the plaintiffs herein but that said actions were undertaken by defendant automatically and solely in an attempt to increase profits from said loan or the funds it represents without regard to its secured position or any particular facts or data relating to this transaction or the plaintiffs herein.

11. An actual controversy has arisen and now exists between plaintiffs and defendant FIDELITY FEDERAL concerning their respective rights and duties in that plaintiffs contend that the clause just alleged is unenforceable without

prior showing of reason and/or justification for its use, under the circumstances of this case; while defendant FIDELITY FEDERAL contends that the clause is enforceable automatically in all cases of outright sale, and that the sale by plaintiffs' vendors of the above described real property breached the clause and entitled defendant FIDELITY FEDERAL to payment of the total principal sum of the note alleged above, plus certain penalty fees.

12. More particularly, the controversy raises the following opposing contentions:

A. Plaintiffs contend and defendant FIDELITY FEDERAL denies as follows:

That automatic enforcement of the alleged clause unlawfully restrains alienation as controlled by Civil Code Section 711 where the trustor's sales of the lender's security does not lessen its value or cause any threat or injury or loss to the lender. That in the circumstances of this case, the real property described above was not and will not be made less valuable as security to defendant FIDELITY FEDERAL by its subsequent sale to plaintiffs.

That defendant FIDELITY FEDERAL cannot contend that the sale of the real property involved in this litigation will in this case lessen its value as security since plaintiffs ask only to pay the installment obligation under the loan and trust deed alleged above.

B. Plaintiffs contend and defendant FIDELITY FEDERAL denies that said clause is enforceable only where the beneficiary can show that his secured position has been or will be impaired or jeopardized by reason of the transfer of the security property and that said clause may not be enforced in an effort to increase profits by raising the interest rate and charging loan assumption fees and other penalties or by declaring all sums due and payable that they may be

re-loaned at a higher interest rate. Plaintiffs further contend and defendant denies that enforcement of the clause in an effort to increase profits from said loan or the funds it represents constitutes a restraint upon alienation for which no lawful justification exists and is a violation of public policy and California law.

C. Plaintiffs contend and defendant FIDELITY FEDERAL denies, that defendant's foreclosure proceedings are willful, intentional, deliberate, obstinate, and undertaken with malicious intent.

13. Plaintiffs desire a judicial determination and declaration that the clause alleged above is not enforceable against them without a showing by defendant FIDELITY FEDERAL of harm or injury to be incurred and that defendant is enjoined from foreclosing on the subject trust deed in reliance on said clause, without first showing of harm to defendant resulting from the transfer alleged in this complaint.

14. Plaintiffs have no adequate remedy at law and will suffer irreparable damage in the loss of their valuable equity in said real property. As a result of defendant's aforesaid action, plaintiffs now face the threat of the foreclosure sale of their real property, unless they can raise the necessary sum required to pay off the entire loan obligation as demanded by defendant, plus the prepayment penalties and costs defendant seeks, which sum is in excess of plaintiffs' means to raise within the time allotted by defendant and applicable statutory law.

SECOND CAUSE OF ACTION
(Slander of Title)

15. Plaintiffs hereby reallege paragraph 1 through 7, inclusive, of the First Cause of Action and incorporate them herein as though set forth in full.

16. On or about December 7, 1977, defendant FIDELITY FEDERAL willfully, maliciously, and without justification, published a claim that plaintiffs were in default under said trust deed, well knowing that such claim was false. At no time herein mentioned nor at the present time have plaintiffs been in default respecting their obligations under said trust deed.

17. Defendant, at the time of said publication:

A. Knew and intended that such publication would be received by third parties, including, but not limited to, prospective lenders and contractors, prospective purchasers of plaintiffs' interest under the trust deed, prospective lessees of said property and portions thereof, and other members of the real estate industry.

B. Knew and intended that said parties would understand said publication as referring to the interest of plaintiffs under the trust deed and as denying the continued existence of plaintiffs' interest or as asserting a diminution in the value thereof.

C. Knew and intended that the conduct of such third parties as prospective lenders, contractors, purchasers, and lessees would be determined by their knowledge of the matter so published.

D. Knew that the rights of plaintiffs under the trust deed were valid and subsisting, that no ground existed for claiming default of the trust deed, that in fact plaintiffs were not in default under the trust deed, and that said published claim was wholly false.

18. Said claim of defendant so published was in fact understood by such third parties in the manner so intended by defendant that it be understood.

19. As a further disparagement to plaintiffs' title, defendants on that same date caused to be recorded a Notice

of Default on the real property. In recording said instrument, defendants cast a cloud on and a slander on plaintiffs' title to the real property described herein; recording of said Notice of Default by defendant has rendered the real property unmarketable, all to the damage of said real estate and to plaintiffs in the approximate sum of $315,000.00.

20. As a further direct and proximate result of said disparagement, it has become necessary for plaintiffs to employ legal counsel to seek a judicial declaration of plaintiffs' rights under the trust deed, and to clear plaintiffs' said fee interest of the cloud created by said disparagement. The cost to plaintiffs of seeking such judicial declaration cannot presently be ascertained. Plaintiffs pray that, at such time as the extent of such costs can be ascertained, plaintiffs be permitted to amend this complaint to state the amount thereof.

21. As a further direct and proximate result of said willful and malicious disparagement, it has become impossible for plaintiffs to secure financing for the continued development of said property. As a result of said disparagement, development of the real property has ceased, and said development cannot be resumed so long as the rights of plaintiffs under the trust deed are under the cloud of said disparagement. As a direct and proximate result thereof, plaintiffs have been damaged in the sum of $315,000.00, said sum being the fair and reasonable market value of the real property, and to an additional extent which cannot presently be ascertained. Plaintiffs pray that, at such time as the extent of said additional damage can be ascertained, plaintiffs be permitted to amend this complaint to restate the amount of said damage.

22. The acts of said defendants, and each of them, as herein alleged, have been actuated by malice, and said defendants, and each of them, have been guilty of oppression

and malice in their actions; this is a proper case for punitive damages and these plaintiffs have sustained exemplary and punitive damages in the sum of $500,000.00.

THIRD CAUSE OF ACTION
(Injunction)

23. Plaintiffs hereby reallege Paragraphs 1 through 14, inclusive, of the First Cause of Action and incorporate each hereby by reference as though set forth in full.

24. That the within action filed by plaintiffs will not come before the above-entitled court for trial on the merits until after the date upon which defendant may legally hold a sale of plaintiffs' real property.

25. That the sale thereof will cause plaintiffs grievous and irreparable injury and loss, and they will be irrevocably divested of all right, title and interest in and to the real property, as well as suffering the loss of a substantial cash investment made therein pursuant to the purchase thereof.

26. That said sale of real property prior to the trial in this action will cause plaintiffs grievous and irreparable loss without affording plaintiffs opportunity to argue their case upon its merits before the above-entitled court. The sale of the real property prior to adjudication will in actual fact render this action moot, leaving plaintiffs to absorb all costs therefrom without having obtained the benefit of a court hearing.

27. To prevent said injury and harm and to assure plaintiffs their constitutionally guaranteed rights of due process in a hearing upon their action, plaintiffs seek to temporarily enjoin defendant from any further perpetration of acts relating to or constituting a sale of the subject real property.

PRAYER

WHEREFORE, plaintiffs pray judgment against defendants as follows:

For the First Cause of Action:

1. A judicial determination and declaration that the acceleration (due-on-sale) clause in the subject trust deed is not enforceable against plaintiffs without defendant FIDELITY FEDERAL first demonstrating harm to its security interest;

2. A permanent injunction against any foreclosure proceedings in reliance on said clause as alleged herein;

3. A judicial determination and declaration that defendants have maliciously impugned plaintiffs' title to the subject real property, and that no default under the subject trust deed in fact exists;

4. General damages in the sum of $315,000.00;

5. Exemplary damages in the sum of $500,000.00;

6. Reasonable attorneys' fees incurred herein;

7. Costs of suit incurred herein, and

8. For such other and further relief as the Court may deem proper.

Dated:

FRED CRANE,
A Professional Corporation
By /s/ Fred Crane
Fred Crane
Attorneys for Plaintiffs.

EXHIBIT A.

DEED OF TRUST

(With Assignment of Rents and Incorporating Recorded Provisions)

Book 9586, Page 869

(This is ☐ is not ☒ a Construction Trust Deed). Loan No. 53625-MG.

THIS DEED OF TRUST made the 18th day of January, 1971 between HOWARD G. TRABANT and ELLEN MAE TRABANT, husband and wife the Owner, herein called Trustor, whose address is 8077 Yorktown, Huntington Beach, California and Gateway Mortgage Corporation, a Corporation, herein called Trustee, and FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, a United States Corporation, the Lender, herein called Beneficiary.

1. TRUSTOR, FOR THE PURPOSE OF SECURING:

(a) The payment according to its terms, of Trustor's Promissory Note of even date herewith in the principal sum of $105,000.00 together with interest thereon payable to Beneficiary, or order, and all extensions and renewals thereof;

(b) Performance of each agreement of Trustor incorporated by reference or herein contained;

(c) The payment of all sums of money with interest which may be paid out or advanced by, or may otherwise be due to Trustee or Beneficiary under any provision of this Deed of Trust;

(d) Payment of such further sums as the record owner of the subject property may hereafter borrow from Beneficiary, its successors or assigns when said borrowing is evidenced by a promissory note or notes reciting that it or they are so secured;

(e) Performance of each agreement of Trustor contained in any building loan agreement, entered into between Trustor and Beneficiary, for the construction of improvements on the herein described property;

(f) Payment, with interest thereon, of any other present or future indebtedness or obligation of Trustor (or of any successor in interest of the Trustor to said property) to the Beneficiary, whether created directly or acquired by assignment, whether absolute or contingent, whether due or not, whether otherwise secured or not, or whether existing at the time of the execution of this Deed of Trust, or arising thereafter; and

(g) Performance and discharge of each and every obligation, covenant and agreement of Trustor herein contained and in any and all pledge agreements, supplemental agreements, assignments of lessor's interests in leases, or other instruments of security, or rental assignments, executed by Trustor as of even date herewith or at any time subsequent to the date hereof for the purpose of further securing any indebtedness hereby secured, or any part thereof, or any further advancements of further or additional loans of any sums hereafter made by Beneficiary or any successor of Beneficiary holding this note, to Trustor or any successor of Trustor owning the real property described herein during the continuance of these trusts and secured hereby, or for the purpose of supplementing or amending this Deed of Trust or any instrument secured hereby; HEREBY IRREVOCABLY GRANTS, TRANSFERS AND ASSIGNS TO TRUSTEE IN TRUST WITH POWER OF SALE, that certain real property in the County of Orange, State of California, described as:

> The East 195 feet of the West 355 feet of the South 230 feet of the West one half of the Southwest quarter of the Northwest quarter of Section 1, in Township 6

south, Range 11 West in the Rancho Las Bolsas, in the City of Huntington Beach, as shown on a map thereof recorded in Book 51 Page 7, Miscellaneous Maps, records of said Orange County

EXCEPTING THEREFROM the North 50 feet of the West 40 feet thereof.

commonly known and designated as 19474 - 19490 Beach Blvd., Huntington Beach, California.

TOGETHER WITH all interest which Trustor now has or may hereafter acquire in or to said property and in and to: All sums of money payable on the purchase price of said property secured by a lien thereon or payable under any agreement for the sale thereof; All easements and rights of way appurtenant thereto; All buildings and improvements now and hereafter located thereon; All adjacent lands within enclosures or occupied by buildings partly on the above described property; All water and water rights (whether or not appurtenant) and shares of stock pertaining to water and water rights; All personal property of every kind and nature whatsoever, other than consumable goods, now or hereafter located in or upon said real estate or any part thereof and used or usable in connection with any present or future operation of said property (hereinafter called "equipment") and now owned or hereafter acquired by Trustor, including, but without limiting the generality of the foregoing; All inlaid floor coverings, shrubs, trees, carpeting, drapes and drape rods, garbage disposals, dishwashers, water heaters, plants, machinery, apparatus, fittings, fixtures, heating, lighting, laundry, incinerating, power equipment, engines, pipes, pumps, tanks, motors, conduits, switchboards, plumbing, lifting, cleaning, fire prevention, fire extinguishing, refrigerating, ventilating, communications apparatus, air cooling and air conditioning apparatus, elevators, escalators, shades, awnings, screens, storm doors and win-

dows, stoves, refrigerators, attached cabinets, partitions, ducts and compressors, and all of the right, title and interest of Trustor in and to any equipment which may be subject to any security agreement, conditional bill of sale or chattel mortgage superior in lien to this Deed of Trust. It is understood and agreed that all said personal property and equipment is part and parcel of said real property and appropriated to the use of said property and whether affixed or annexed or not, shall for the purposes of this Deed of Trust be deemed conclusively to be real property and conveyed hereby. Trustor agrees to execute and deliver, from time to time, such further instruments as may be requested by Beneficiary to confirm the lien of this Deed of Trust on any such equipment.

2. TRUSTOR ABSOLUTELY AND IRREVOCABLY ASSIGNS to Beneficiary the rents, issues and profits of the subject property for the purposes and upon the terms and conditions hereinafter set forth.

3. Trustor agrees, by the execution and delivery hereof, that Trustor shall pay $15.00 or such greater amount authorized by law, for a written statement of obligation (C.C.C. 2943) regarding the obligation secured by this Deed of Trust.

4. TRUSTOR AGREES:

(a) Taxes, Liens and Fees: To pay, when due, at least 10 days before delinquency, all taxes, bonds and assessments including assessments on appurtenant water stock, with interest, fees, and penalties, and to pay, when due, all other charges, liens and encumbrances, with interest, fees, and penalties, which now are or shall hereafter be or appear to be a lien upon said property or any part thereof, and to pay all costs, fees, and expenses of this trust, and in default thereof, Trustee or Beneficiary, without obligation so to do

and without demand or notice upon Trustor, may pay the same. Trustee or Beneficiary shall be the sole judge of the legality thereof and of the amounts necessary to be paid. (1) In the event of the passage after the date of this Deed of Trust of any law of the State of California, deducting from the value of real property for the purposes of taxation any lien thereon, or changing in any way the laws of the taxation of deeds of trust or debts secured by deed of trust for state or local purposes, or the manner of the collection of any such taxes, so as to affect this Deed of Trust, the holder of this Deed of Trust and of the debt which it secures shall have the right to declare the principal sum and the interest due on a date to be specified by not less than thirty (30) days' written notice to be given to Trustor by Beneficiary; provided, however, that such election shall be ineffective if Trustor is permitted by law to pay the whole of such tax in addition to all other payments required hereunder and, if prior to such specified date, does pay such tax and agrees to pay any such tax when hereafter levied or assessed against the premises, and such agreement shall constitute a modification of this Deed of Trust. (2) To include as an addition to each monthly payment provided for in the note secured by this Deed of Trust, should Beneficiary so elect, a sum necessary to establish an adequate reserve for use in payment of annual taxes, assessments and insurance premiums. This reserve shall be non-interest bearing and until disbursed, or applied as provided hereinafter, at option of Beneficiary, constitutes security for the loan, and may be commingled with other funds of the Beneficiary. Prior to disbursement or application thereof, said funds may be utilized by Beneficiary who is entitled to all earnings thereon, if any.

(b) Insurance: To keep said property insured against loss or damage by fire and other risk which, in the opinion

of Beneficiary, should be insured against, under policies of insurance with loss payable to Beneficiary (by means of a loss payable clause of endorsement in a form satisfactory to Beneficiary and without contribution, if obtainable) in form, amount and companies acceptable to Beneficiary. Said policies shall be delivered to, and remain in possession of Beneficiary as further security for the faithful performance of these obligations, which delivery shall constitute an assignment by Trustor to Beneficiary of all rights thereunder, including return of premium; to deliver to Beneficiary a policy or policies renewing or extending any expiring insurance with a receipt showing premiums paid at least thirty (30) days before expiration and in default thereof, Beneficiary may procure such insurance as it may elect and may make payment of premiums thereon which payment is repayable on demand and is secured hereby, or charge Trustor a reasonable service fee, or an amount authorized by law for the costs of processing any late insurance policy. In no event and whether or not default hereunder has occurred shall Beneficiary, by the fact of approving, accepting or obtaining such insurance, incur any liability for the amount of such insurance, the form or legal sufficiency of insurance contracts, solvency of insurers, or payment of losses by insurers, and Trustor hereby expressly assumes full responsibility therefor and liability, if any, thereunder. In case of any loss the amount collected under any policy of insurance on said property may, at the option of the Beneficiary, be applied by Beneficiary upon any indebtedness and/or obligation secured hereby and in such order as Beneficiary may determine; or said amount or any portion thereof may, at the option of the Beneficiary, either be used in replacing or restoring the improvements partially or totally destroyed to a condition satisfactory to said Beneficiary, or be released to the Trustor, in either of which events

neither the Trustee nor the Beneficiary shall be obligated to see the proper application thereof; nor shall the amount so released or used be deemed a payment on any indebtedness secured hereby. Such application, use, and/or release shall not cure or waive any default or notice of default hereunder or invalidate any act done pursuant to such notice; any unexpired insurance and all returnable insurance premiums shall inure to the benefit of, and pass to, the purchaser of the property covered thereby at any Trustee's sale held hereunder. For each cancellation or substitution of a policy of insurance by the Trustor, the Beneficiary reserves the right to make a charge not to exceed $10.00. Said charge, secured hereby, shall be immediately due and payable, but, at Beneficiary's option, it may be added to the loan.

(c) Maintenance: To keep said property in good condition and repair; to complete or restore promptly and in good and workmanlike manner any building which may be constructed, damaged or destroyed thereon and to pay, when due, all claims for labor performed and materials furnished therefore and for any alterations thereof; to comply with the provisions of all insurance policies covering, and with all laws, ordinances and regulations affecting said property; not to remove, demolish or materially alter any building at any time thereon unless the written consent of Beneficiary is first had and obtained; not to allow the said property to become unoccupied or vacant for a period of three (3) or more successive months at any one time; not to commit or permit any waste thereof or any act upon said property in violation of law or of deed restrictions; to cultivate, irrigate, fertilize, fumigate, prune and do all other acts, in a timely and proper manner, which from the character or use of said property may be reasonably necessary to protect and preserve said security, the specific enumerations herein not excluding the general.

(d) Construction of Improvements: If the loan secured hereby or any part thereof is being obtained for the purpose of construction of improvements on said property, Trustor also agrees, anything in this Deed of Trust to the contrary notwithstanding: (1) to complete same in accordance with plans and specifications satisfactory to Beneficiary; (2) to allow Beneficiary to inspect said property at all times during construction; (3) to replace any work or materials unsatisfactory to Beneficiary, within fifteen (15) calendar days after written notice from Beneficiary of such fact, which notice may be given to the Trustor by registered mail, sent to his last known address, or by personal service of the same; (4) that work shall not cease on the construction of such improvements for any reason whatsoever for a period of fifteen (15) calendar days. Trustor agrees to commence said construction within (30) days after the recordation of this instrument, and to diligently and efficiently complete said construction without delay. In the event the Trustor or any contractor engaged by the Trustor shall cease work upon said construction prior to its completion, then the Beneficiary herein shall have the immediate right, with or without notice to the Trustor, to go upon the premises and to complete or have completed the construction, and the advances, if any, made by the Beneficiary for the completion of said construction will be secured by this Deed of Trust and shall be due and payable by the Trustor upon demand by the Beneficiary; to maintain, at all times during construction, a display sign in a form acceptable to Beneficiary stating Beneficiary is the construction lender.

(e) Defending Trust: To defend this Trust in any action or proceeding purporting to affect said property, and to file and prosecute all necessary claims and actions to prevent or recover for damage to, taking of, or destruction of said property; and either Trustee or Beneficiary, or both, at any

time during the continuation of this Trust, is hereby authorized, without obligation so to do, to commence, appear in or defend any such action or proceeding, whether brought by or against Trustor, Beneficiary or Trustee, or with or without suit, to exercise or enforce any other right, remedy, or power available or conferred hereunder, whether or not judgment be entered in any action or proceeding; and Trustee or Beneficiary may commence, appear or intervene in any action or proceeding, and retain counsel therein, and take such action therein, as either may be advised, and may settle, compromise or pay the same or any other claims and, in that behalf and for any of said purposes, may expend and advance such sums of money as either may deem reasonable. Trustor agrees to pay all attorney's fees and costs incurred by Beneficiary should Beneficiary be made a party to any litigation in which Trustor is also a party, the repayment of which, together with interest thereon at the rate provided in said promissory note, is secured hereby.

(f) Reimbursement: Beneficiary or Trustee, without obligation so to do or notice to or demand upon Trustor and without liability for anything done or omitted while performing the same and without releasing Trustor from any obligation hereunder, may perform any act herein agreed to be performed by Trustor; and Trustor will repay to Trustee or Beneficiary, upon demand, all amounts which they or either of them may incur in defending this Trust or in exercising any right, privilege or remedy hereunder, including, but not limited to, cost of surveys, evidence of title, court costs and reasonable attorneys' fees, together with interest thereon at the rate of ten percent (10%) per annum, the repayment of which is secured hereby.

(g)(1) Condemnation: All settlement, awards or damages in connection with any condemnation for public use of or any injury to said property, or any part thereof, from

same, are hereby assigned and shall be paid to Beneficiary, which may apply said moneys to any indebtedness secured hereby or release the same, or any part thereof, as it may elect. (2) Injury to Property: All causes of action, whether accrued before or after the date of this Deed of Trust, of all types for damage or injury to said property or any part thereof, or in connection with this transaction financed by funds loaned to Trustor by Beneficiary or in connection with or affecting said property or any part thereof, including causes of action arising in tort or contract and causes of action for fraud or concealment of a material fact, are, at Beneficiary's option, assigned to Beneficiary and the proceeds shall be paid to Beneficiary, who may, after deducting therefrom all its expenses, including reasonable attorneys' fees, apply or release any moneys so received by it in such manner and with the same effect as above provided for the disposition of proceeds of fire and other insurance. Beneficiary may at its option appear in and prosecute in its own name any action or proceeding to enforce any such cause of action and may make any compromise or settlement thereof. Trustor agrees to execute such further assignments of any compensation award, damage and causes of action as Beneficiary shall request.

(h) Inspection: Either Beneficiary or Trustee, or both, at any time during the continuation of this Trust may enter and inspect said encumbered property.

(i) Reconveyance: If Trustor shall pay or cause to be paid in full said promissory note and all sums herein agreed to be paid by Trustor or secured hereby and the interest thereon, and also the reasonable expense of this Trust, then Trustee, upon delivery to it of this Deed of Trust, said promissory note marked fully paid, and satisfactory evidence of the payment in full of all other indebtedness hereby secured, shall, upon the written request of Beneficiary, re-

convey, without warranty regarding title, possession or encumbrance, all of the estate in said property granted to Trustee under the terms hereof and not theretofore reconveyed. The grantee in such reconveyance may be described and designated as "the person or persons legally entitled thereto" or "the present holders of the equitable title of real property described in said Deed of Trust." All reconveyances in whole or in part shall be at the sole cost of the grantee. The recitals in such reconveyance of any matters or facts shall be conclusive proof of the truthfulness thereof.

(j) Late Charge: To Pay "late charge" provided for in any note secured hereby.

(k) Default: Default shall occur if: (1) payment of performance of any note, indebtedness, liability or obligation secured hereby or of any interest thereon be not made at the time or in the manner agreed; or (2) Trustor fails to perform any of its obligations hereunder; or (3) should Trustor or any successor in interest to Trustor in such property sell, sell under contract of sale, lease with option to purchase, convey, transfer, encumber, or alienate said property, or any part thereof, or any interest therein, or drill or extract or enter into a lease for the drilling or extraction of oil, gas or other hydrocarbon substances or any mineral of any kind or character therefrom, or from any part thereof, or be divested of his title or any interest therein in any manner or way, whether voluntary or involuntary, Beneficiary shall have the right, at its option, to declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in any note or written agreement evidencing the same, immediately due and payable, and no waiver of this right shall be effective unless in writing and signed by Beneficiary; waiver of this right granted to Beneficiary as to one transaction or occurrence shall not be deemed to be a waiver of said right as to any subsequent

transaction or occurrence; if Beneficiary exercises said option and Trustor fails to pay all such sums, it shall constitute a default hereunder; or (4) if this Deed of Trust or any note secured hereby provides any charge for prepayment of any indebtedness secured hereby and Trustor fails to pay same, Trustor agrees to pay said prepayment charge if any of said indebtedness shall be paid prior to the due date thereof stated in said note or this Deed, even if and notwithstanding Trustor shall have defaulted in payment thereof, or in performance of any agreement hereunder, and Beneficiary, by reason thereof, shall have declared all sums secured hereby immediately due and payable; or (5) said property be subject to abatement proceedings; or (6) any financial information given by Trustor to Beneficiary be not true in any material respect or any essential financial information be withheld by Trustor from Beneficiary; or (7) said property, or any part thereof, be attached or become subject to any other legal process and be not released therefrom within ninety (90) days; or (8) Trustor(s) (or any one of them) die, be declared incompetent, become insolvent, make an assignment for the benefit of creditors, be the subject of any bankruptcy proceeding, re-organization, arrangement, insolvency, receivership, liquidation or dissolution proceedings; or (9) (In the event that the indebtedness secured hereby was incurred for the purpose of enabling Trustor to acquire said property for his dwelling and Trustor shall fail at any time to occupy such property as his dwelling without the prior written consent of the Beneficiary being first obtained.) the Trustee, upon presentation to it of an affidavit signed by Beneficiary setting forth facts showing a default by Trustor under this paragraph is authorized to accept as true and conclusive all facts and statements therein, and to act thereon hereunder.

(l) Remedies: Upon the happening of any such default, Beneficiary or Trustee, or both, may, without the necessity of any notice to or demand upon Trustor or any other party liable for the said indebtedness or having an interest in said property, may do any or all of the following: (1) declare all indebtedness secured hereby immediately due and payable; (2) take possession of and operate said property and any personal property thereon used in the operation of said property and any business conducted thereon without liability or obligation on his part, and do all such acts affecting said property as Beneficiary may deem necessary to conserve the value thereof; (3) to the extent permitted by law, bring an action to enforce the payment of any note or indebtedness secured hereby without the necessity of exercising any remedy hereunder or the prior sale of said property and without thereby waiving any other right or remedy; (4) perform any of the foregoing acts with or without bringing any action or proceeding, or through a receiver appointed by a court, and in any case without necessity of having given or recorded any notice of default or election to sell and without regard to the adequancy of security; (5) bring an action in any court of competent jurisdiction to foreclose this Deed of Trust; (6) elect to sell said property or any part thereof; (7) apply any funds in possession of Beneficiary including, but not limited to, funds under the provisions of paragraphs 4(a) and 3(b), at option of Beneficiary; to the payment of principal and/or interest upon the obligation secured hereby in lieu of being applied to any of the purposes for which the fund was established.

(m) Sale: In case of election to sell. Trustee or Beneficiary shall record in each office of the Recorder of the County wherein said property or any part thereof is situated a notice of default and of the election of Beneficiary to sell said property. Such notice of default shall contain such

further recitals as may be required by law, and after notice of its recordation has been given to all parties entitled thereto, and the period required by law shall have elapsed following the recordation of said notice of default, Trustee, without demand on Trustor, after giving the notices required by law, shall sell said property, or such part thereof as in its sole discretion it shall find necessary, in the manner required by law. Trustee may postpone said sale either by publishing, prior to the date thereof, a notice of such postponement in the same newspaper in which the original notice of sale was published, or by public announcement at the time and place fixed in the original notice of sale, and may thereafter postpone said sale from time to time by like publication or announcement, and at the time and place so advertised or to which such sale may have been postponed. Trustee may sell the property as a whole or in parcels, and if in parcels in such order, as Trustee may determine at public auction to the highest bidder for cash in lawful money of the United States. Said sale may take place in any County in which the property or any portion thereof is located. Trustee in conducting said sale may act through agents, attorneys or auctioneers. Any person, including Trustor or Trustee or Beneficiary, may purchase at such sale.

(n) Proceeds of Sale: Upon such sale, Trustee shall, after receipt of the amount paid, deliver to the purchaser its Deed conveying said property without warranty as to title, possession or encumbrances and shall apply the proceeds of the sale in the following order to the payment of: (1) expenses of sale; (2) costs, fees, charges and expenses of Trustee and of this Trust, including attorney's fees in a reasonable amount; (3) costs of evidence of title and Trustee's fee in connection with such sale; (4) all sums expended under any of the terms hereof by Trustee or Beneficiary not then repaid, with accrued interest at the rate

of ten percent (10%) per annum; (5) accrued interest on said note or notes; (6) unpaid principal of said note or notes; and (7) all other obligations of Trustor to Beneficiary secured hereby; and any remainder shall be paid to the person or persons legally entitled thereto upon proof of such right. The recitals in such Deed of any matters, proceedings and facts shall be conclusive proof of the truthfulness and regularity thereof. Trustor agrees to surrender possession of said property to the purchase immediately and without demand.

(o) Consent, etc.: Without affecting the liability of any person, including Trustor, for the payment of any indebtedness secured hereby or the lien of this Deed of Trust for the full amount of the indebtedness then remaining unpaid (other than any person or property specifically released by Beneficiary), Beneficiary or Trustee, if so requested by Beneficiary, may from time to time without liability of Beneficiary or Trustee therefor and without notice do any one or more of the following: (1) release any indebtedness; (2) extend the time or otherwise alter the terms of payment of any such indebtedness; (3) accept additional security; (4) substitute or release any property securing such indebtedness; (5) reconvey any part of said property; (6) consent to the making of any map or plat thereof; (7) join in granting any easement thereon; or (8) join in any extension agreement or any agreement subordinating the lien or charge hereof.

(p) Assumption: If an assumption of the loan secured by this Deed of Trust is approved by Beneficiary, it shall not release Trustor from any obligations hereunder.

(q) Payment for Services: Beneficiary may charge Trustor a reasonable fee for any other service rendered Trustor, or on his behalf, connected with this Deed, or the loan secured hereby, including, without limiting the generality of the foregoing, the delivery to an escrow holder of a

request for full or partial reconveyance of this Deed; transmitting to an escrow holder moneys secured hereby; changing its records pertaining to this Deed and the loan secured hereby to show a new owner of said property; replacing an existing policy of fire insurance or other casualty insurance, held by Beneficiary hereunder, with another such policy. Any such charge shall be secured hereby and Trustor agrees to pay the same, together with interest from the date of such charge at the rate of ten percent (10%) per annum immediately and without demand.

5. GENERAL PROVISIONS: IT IS MUTUALLY AGREED THAT:

(a) Beneficiary may, at any time by instrument in writing acknowledge by Beneficiary and record in the Office of the Recorder of the County or counties where said property or any part thereof is situated, appoint a new Trustee in place of the Trustee named herein, who shall thereupon have all of the estate, powers and duties of the predecessor Trustee.

(b) Trustee may at any time, and without notice, upon written request of Beneficiary reconvey any portion of said property to the persons legally entitled thereto without warranty as to title, possession or encumbrance, without affecting the personal liability of any person for the payment of said note or any indebtedness secured hereby or the lien of the Deed of Trust on the remainder of said property.

(c) Acceptance by Beneficiary of any sum on account of any indebtedness secured hereby, after the date when such sum is due or after recording a notice of default and election to sell, shall not constitute a waiver of the right either to require prompt payment when due of all sums secured hereunder or to declare a default for failure to pay or a waiver of the right to proceed with the sale of said

property under such notice for any unpaid balance of said indebtedness.

(d) No remedy herein provided shall be exclusive of any other remedy herein or now or hereafter existing by law, but shall be cumulative. Every power or remedy hereby given to Trustee or to Beneficiary or to which either of them may be otherwise entitled, may be exercised from time to time and as often as may be deemed expedient by them, and either of them may pursue inconsistent remedies. If Beneficiary holds any additional security for any obligation secured hereby, it may enforce the sale thereof at its option, either before, contemporaneously with, or after the sale is made hereunder, and on any default of Trustor, Beneficiary may, as its option, offset against any indebtedness owing by it to Trustor, the whole or any part of the indebtedness secured hereby, and the Beneficiary is hereby authorized and empowered at its option, without any obligation so to do, and without affecting the obligations hereof, to apply toward the payment of any indebtedness of the Trustor to the Beneficiary, any and all sums or money which the Beneficiary may have in its possession or under its control, including without limiting the generality of the foregoing, the indebtedness evidenced by an investment certificate or any escrow or trust funds.

(e) Trustee or Beneficiary, or both, may at any time after the expiration of five (5) years after Trustee ceases to act under, or has conveyed or otherwise ceased to hold all property subject to this Deed of Trust, destroy without liability for so doing all documents, papers and correspondence (including this Deed of Trust) relating thereto.

(f) Despite any contrary provision herein or in the promissory note of Trustor, Beneficiary shall have the absolute right to direct the manner in which payments or proceeds

shall be applied upon or allocated among the various items composing Trustor's indebtedness secured hereby.

(g) Whenever the context so requires, the masculine includes the feminine and neuter and the singular includes the plural. The term "Beneficiary" includes not only the original Beneficiary hereunder but also any future owner and holder including pledgees of the promissory note and indebtedness secured hereby.

(h) Time is of the essence of all Trustor's obligations hereunder; and to the extent permitted by law, Trustor waives all present or future statutes of limitation with respect to debt, demand or obligations secured hereunder in any action or proceeding for the purpose of enforcing this Trust or any rights or remedies thereunder.

(i) Recourse may be had against the separate property of any Trustor who is a married women for all indebtedness or liability to Beneficiary hereunder.

(j) This Deed applies to, inures to the benefit of, and binds all parties hereto, their heirs, legatees, devisees, administrators, executors, successors, and assigns.

(k) Trustee accepts this Trust when this Deed, duly executed and acknowledged, is made a public record as provided by law. Trustee is not obligated to notify any party hereto of pending sale under any other Deed of Trust or of any action or proceeding in which Trustor, Beneficiary, or Trustee shall be a party unless brought by Trustee.

(l) If two or more persons be designated as Trustee herein, any, or all, powers granted herein to Trustee may be exercised by any of such persons, if the other person or persons is unable, for any reason, to act, and any recital of such inability in any instrument executed by any of such persons shall be conclusive against Trustor, his heirs, and assigns.

(m) This Deed of Trust cannot be changed except by agreement in writing signed by Trustor and Beneficiary.

(n) Beneficiary confers upon Trustor the authority, during the continuance of these trusts, to collect and retain the rents, issues and profits of the subject property as they become due and payable and to collect all sums of money payable on the purchase of said property secured by a lien thereon or payable under any agreement for sale thereof subject, however, to the right of Beneficiary to revoke said authority at any time in its sole discretion and without notice to Trustor, and without regard to the adequacy of any security for the indebtedness hereby secured. Beneficiary may revoke said authority and, either in person, by agent, or by a receiver appointed by a court, collect and retain the said rents, issued and profits, and sums of money (including those past due and unpaid) whether or not Trustor is in default hereunder or under any of the obligations secured hereby, and with or without, at Beneficiary's option, taking possession of all or any part of the subject property. Any rents, issues and profits or other sums collected may be applied by Beneficiary, less costs and expenses of operating and collection, including reasonable attorneys' fees, in its sole discretion, against the indebtedness secured hereby, any obligations of Trustor arising hereunder or any other obligations of Trustor to Beneficiary, whether existing on the date hereof or hereafter arising. Collection of any rents, issues and profits and other sums of money by Beneficiary shall not cure or waive any default or notice of default hereunder or invalidate any acts done pursuant to such notice.

(o) Beneficiary or Trustee, or both, are authorized to enter upon the herein described property to protect the security hereof. Beneficiary or Trustee, or both, are authorized to commence, appear in and defend any action or proceeding

purporting to affect the security hereof or the rights, powers, duties or liabilities of Beneficiary or Trustee, or both, or the payment of any funds in possession of either the Beneficiary or Trustee arising out of or in connection with this Deed of Trust or loan; to pay, purchase, contest or compromise any encumbrance, charge or lien which in the judgment of either appears to be prior or superior hereto; and, in exercising any such powers, pay necessary expenses, employ counsel and pay his reasonable fees.

(p) Trustor will pay immediately and upon demand all sums, costs, fees and expenses (including, but not limited to, reasonable expenses for service of attorneys, accountants, real estate brokers and other persons and for contractors for labor and materials) incurred or paid by Beneficiary or Trustee to defend this trust, protect the property secured hereunder or in the exercise of any right, power or remedy for which provision is made hereunder or by law, with interest thereon at ten percent (10%) per annum from the date of expenditure thereof by Beneficiary or Trustee until paid, and the same shall be secured hereby; and to the extent that any funds in possession of either the Beneficiary or Trustee are sufficient, the Beneficiary or Trustee shall have the right, but shall not be obligated to pay said sums, costs, fees and expenses out of said funds in lieu of the funds being applied as otherwise provided herein.

(q) If the security under this Deed of Trust is a condominium or a community apartment or planned development project, Trustor agrees to perform each and every obligation of the owner of such condominium or interest in such project under the declaration of covenants, conditions and restrictions pertaining to such condominium or project. Upon the request of Beneficiary, Trustor agrees to enforce against other owners in such condominium or project each and every obligation to be performed by them, if the same

have not been performed or valid legal steps taken to enforce such performance within ninety (90) days after such request is made.

(r) If the security for this Deed of Trust is a leasehold estate, Trustor agrees not to amend, change, terminate or modify his leasehold interest or any subleases or rental agreements thereunder, or agree to do so, without the written consent of Beneficiary being first obtained. In the event of a violation of this provision, Beneficiary shall have the right, at its option, to declare all sums secured hereby forthwith due and payable. Consent to one such modification shall not be deemed to be a waiver of the right to require such consent to future or successive amendments, changes or modifications. Waiver of the right to require such consent in one instance shall not be deemed to be a waiver of the right to require such consent in the event of amendments, changes or modifications occurring after the waiver. Trustor agrees to pay, when due, all rental and other payments including, but not limited to, taxes and assessments required under said leasehold, and otherwise to carry out all of the obligations and agreements to be performed by the lessee under the terms of said leasehold. The failure of Trustor to make any rental or other payment when due, or otherwise to perform all of the obligations of the lessee under the terms of said leasehold or this Deed of Trust, shall constitute a default under the terms of this Deed of Trust. A default by Trustor, voluntary or involuntary, curable or not, under the terms of said leasehold shall likewise be deemed to constitute a default under the terms of this Deed of Trust. All sums expended by Beneficiary in curing any default by Trustor under the terms of said leasehold shall be secured hereby, and Trustor agrees to pay to Beneficiary, immediately and without demand, all sums so expended by Ben-

eficiary, with interest from date of expenditure at the rate of ten percent (10%) per annum.

(s) That, should the Trustor or any successor in interest to Trustor in such property drill or extract or enter into a lease for the drilling for or extraction of oil, gas or other hydrocarbon substances or any mineral of any kind or character, Beneficiary shall have the right, at its option, to declare any indebtedness or obligations secured hereby irrespective of the maturity date specified in any note evidencing the same, immediately due and payable, and no waiver of this right shall be effective unless in writing. Consent to one such transaction shall not be deemed to be a waiver of the right to require such consent to future or successive transactions.

(t) To supply the Beneficiary, within ten (10) days after written request, an accurate written report covering the project named in the Beneficiary's request listing the name of each tenant, the amount of monthly rent paid by each tenant, and the current status of each tenant's lease payments. Upon written demand by the Beneficiary, made in any year when this Deed of Trust shall be in existence, Trustor agrees to make in writing and to deliver at the place then designated for the making of payments on the indebtedness secured by this Deed of Trust, within fifteen (15) days from the date of said demand, a sworn itemized statement to Beneficiary of all income and expense in connection with the operation of the property which is secured by this Deed of Trust. Trustor agrees that said statement shall cover the operations for the year preceding the date of said demand. Failure to deliver any such statements to Beneficiary at the time and place required shall constitute a default hereunder and shall entitle Beneficiary to enforce this Deed of Trust in the same manner as for any other default hereunder.

6. Trustor requests that a copy of any notice of default and of any notice of sale be mailed to each Trustor at the following address:

Signature of Trustor(s)	Address
/s/ Howard G. Trabant	(Full address,
HOWARD G. TRABANT	street number
/s/ Elllen Mae Trabant	City, and state—
ELLEN MAE TRABANT	must be given)
	8077 Yorktown
	Huntington Beach,
	California

State of California, County of Orange ss, —

On January 18, 1971 before me, the undersigned, a Notary Public in and for said State, personally appeared Howard G. Trabant, Ellen Mae Trabant known to me to be the person(s) whose name(s) are subscribed to the within instrument and acknowledged that they executed the same.

WITNESS my hand and official seal.

Signature Margaret R. Paskell

Margaret R. Paskell

EXHIBIT B.

Grant Deed

This form furnished by Orange Coast Title Company

Book 12429, Page 291

FOR A VALUABLE CONSIDERATION, receipt of which is hereby acknowledged, Howard G. Trabant and Ellen Mae Trabant, husband and wife hereby GRANT(S) to Reginald De La Cuesta and Margaret De La Cuesta, husband and wife as community property the following described real property in the county of Orange, state of California:

The East 195 feet of the West 355 feet of the South 230 feet of the West one-half of the Southwest quarter of the Northwest quarter of Section 1, Township 6 South, Range 11 West, in the Rancho Las Bolsas; as per map recorded in Book 51 Page 7, et seq., Miscellaneous Maps, in the office of the recorder of said county.

Excepting therefrom the North 50 feet of the West 40 feet thereof.

Dated 10/10/77

/s/ Howard G. Trabant
Howard G. Trabant
/s/ Ellen Mae Trabant
Ellen Mae Trabant

State of California, County of Orange — ss.

On October 13, 1977 before me, the undersigned, a Notary Public in and for said County and State, personally appeared Howard G. Trabant and Ellen Mae Trabant known to me to be the persons whose names are subscribed to the within instrument and acknowledged that they executed the same.

/s/ James P. Larkin
Signature of Notary

EXHIBIT C.

Notice of Default and Election to
Sell Under Deed of Trust
Book 12483, Page 1190

NOTICE IS HEREBY GIVEN: That GATEWAY MORTGAGE CORPORATION, a California corporation, is Trustee, successor Trustee or substituted Trustee, under a Deed of Trust dated January 18, 1971, executed by HOWARD G. TRABANT AND ELLEN MAE TRABANT, Husband and Wife as Trustor to secure certain obligations including One note in the amount of $105,000.00 in favor of FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, a corporation, Beneficiary, recorded as Instrument No. 20430 on March 30, 1971 in Book 9586, Page 869 of Official Records in the office of the County Recorder of Orange County, California. The East 195 feet of the West 355 feet of the South 230 feet of the West one half of the Southwest quarter of the Northwest quarter of Section 1, in Township 6 south, Range 11 West in the Rancho Las Bolsas, in the City of Huntington Beach, as shown on a map thereof recorded in Book 51 Page 7, Miscellaneous Maps, records of said Orange county. EXCEPTING THEREFROM the North 50 feet of the West 40 feet thereof.

That the beneficial interest under such Deed and the obligations secured thereby have not been transferred or assigned;

that a breach of, and default in, the obligations secured by said Deed of Trust have occurred in that

See Exhibit "A" attached hereto.

That by reason thereof the undersigned, the present Beneficiary under said Deed of Trust, has executed and delivered

to said Trustee a written Declaration of Default and demand for sale, and has surrendered to said Trustee such Deed and all documents evidencing obligations secured thereby, and has declared and does hereby declare all sums secured thereby immediately due and has elected, and does hereby elect, to cause the trust property to be sold to satisfy the obligations secured thereby.

Dated:
December 5, 1977

FIDELITY FEDERAL Savings and Loan Association, a corporation formerly known as Fidelity Federal Savings and Loan Association of Glendale, a corporation.

(Seal)

By /s/ Catherine Derieg
Catherine Derieg, Vice President

By /s/ Barbara M. Breeden
Barbara M. Breeden, Asst. Secretary

NOTICE: You may have the right to cure the default described herein and reinstate the mortgage or deed of trust. Section 2924c of the Civil Code permits certain defaults to be cured upon the payment of the amounts required by that section without requiring payment of that portion of principal and interest which would not be due had no default occurred. Where reinstatement is possible, if the default is not cured within three months following the recording of this notice, the right of reinstatement will terminate and the property may be sold.

To determine if reinstatement is possible and the amount, if any, necessary to cure the default, contact the beneficiary

or mortgagee or their successors in interest, whose name and address as of the date of this notice is —

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION
600 NORTH BRAND BLVD., GLENDALE, CALIF. 91203

EXHIBIT A.

Book 12483, Page 1191

"should Trustor or any successor in interest to Trustor in such property sell, sell under contract of sale, lease with option to purchase, convey, transfer, encumber, or alienate said property, or any part thereof, or any interest therein, or be divested of his title or any interest therein in any manner or way, whether voluntary or involuntary, Beneficiary shall have the right, at his option, to declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in any note or written agreement evidencing the same, immediately due and payable"

i.e. The Trustor sold, conveyed, transferred or disposed of said property without the written consent of the Beneficiary being first had and obtained and therefore the Beneficiary has declared all sums secured thereby forthwith due and payable.

Also, the installment of principal and interest which became due on December 1, 1977 and all subsequent installments of principal and interest, the late charges for all delinquent principal and interest installments aforementioned, if any, along with late charges, foreclosure costs, legal fees or advances that may become due.

REQUEST FOR NOTICE
Under Section 2924b Civil Code
Book 12480, Page 1343

In accordance with Section 2924b, Civil Code, request is hereby made that a copy of any Notice of Default and a copy of any Notice of Sale under the Deed of Trust recorded as Instrument No. on 3/30/71 in book 9586, page 869. Official Records of Orange County, California and describing land therein as

> The East 195 feet of the West 355 feet of the South 230 feet of the West one-half of the Southwest quarter of the Northwest quarter of Section 1, in Township 6 South, Range 11 West, in the Rancho Las Bolsas, in the City of Huntington Beach, as per map recorded in Book 51 Page 7 et seq., Miscellaneous Maps, in the office of the county recorder of said county.
>
> Excepting therefrom the North 50 feet of the West 40 feet thereof.

Executed by Howard G. Trabant and Ellen Mae Trabant, husband and wife, as Trustor in which Fidelity Federal Savings and Loan Association is named as Beneficiary, and Gateway Mortgage Corporation as Trustee, be mailed to Reginald De La Cuesta and Margaret De La Cuesta at 7811 Glencoe Avenue, #1, Huntington Beach, California.

Dated 11/23/77

/s/ Sharon Cronholm
Sharon Cronholm

State of California, County of Orange —
On 11/23/77 before me, the undersigned, a Notary Public in and for said County and State, personally appeared Sharon Cronholm, known to me to be the person whose name is

subscribed to the within instrument and acknowledged that she executed the same.

WITNESS my hand and official seal

/s/ Doreen D. La Bate
Notary Public in and for said
County and State.

Answer of Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation to Complaint.

Superior Court of the State of California for the County of Orange.

Reginald D. de la Cuesta, and Margaret de la Cuesta, Plaintiffs, vs. Fidelity Federal Savings and Loan Association, a federally chartered association, Gateway Mortgage Corporation a California corporation, and Does I through X, inclusive, Defendants. No. 28-64-74.

Filed: July 6, 1978.

Defendant Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation answers the Complaint herein as follows:

FIRST CAUSE OF ACTION

1. Answering the allegations of paragraph 1 of the Complaint, defendant Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation (hereinafter collectively "Fidelity") admit said allegations.

2. Answering the allegations of paragraph 2 of the Complaint, Fidelity admits said allegations.

3. Answering the allegations of paragraph 3 of the Complaint, Fidelity has no information or belief sufficient to enable it to answer said allegations, and basing its denial on that ground denies each and every allegation thereof generally and specifically.

4. Answering the allegations of paragraph 4 of the Complaint, Fidelity admits said allegations.

5. Answering the allegations of paragraph 5 of the Complaint, defendant Fidelity Federal Savings and Loan Association admits said allegations.

6. Answering the allegations of paragraph 6 of the Complaint, this answering defendant has no information or belief

sufficient to enable it to answer said allegations and basing its denial on that ground denies each and every allegation thereof generally and specifically.

7. Answering the allegations of paragraph 7 of the Complaint, this answering defendant admits such allegations.

8. Answering the allegations of paragraph 8 of the Complaint, defendant Fidelity Federal Savings and Loan Association admits said allegations.

9. Answering the allegations of paragraph 9 of the Complaint, Fidelity denies each and every allegation thereof generally and specifically.

10. Answering the allegations of paragraph 10 of the Complaint, Fidelity denies each and every said allegation both generally and specifically.

11. Answering the allegations of paragraph 11 of the Complaint, defendant Fidelity admits said allegations.

12. Answering the allegations of paragraph 12 of the Complaint, defendant admits said allegations.

13. Answering the allegations of paragraph 13 of the Complaint, defendant Fidelity admits said allegations.

14. Answering the allegations of paragraph 14 of the Complaint, Fidelity denies each and every said allegation both generally and specifically.

SECOND CAUSE OF ACTION

15. In response to paragraph 15 of the Complaint, Fidelity hereby realleges their previous answers to paragraphs 1 through 14 of the Complaint inclusive of the First Cause of Action and incorporates said answers herein as though set forth in full.

16. Answering the allegations of paragraph 16 of the Complaint, this answering defendant denies each and every said allegation both generally and specifically.

17. Answering the allegations of paragraph 17 of the Complaint, this answering defendant denies each and every said allegation both generally and specifically.

18. Answering the allegations of paragraph 18 of the Complaint, this answering defendant has no information or belief sufficient to enable it to answer said allegations, and basing its denial on that ground denies each and every allegation thereof generally and specifically.

19. Answering the allegations of paragraph 19 of the Complaint, this answering defendant denies each and every said allegation both generally and specifically.

20. Answering the allegations of paragraph 20 of the Complaint, this answering defendant has no information or belief sufficient to enable it to answer said allegations, and basing its denial on that ground denies each and every allegation thereof generally and specifically.

21. Answering the allegations of paragraph 21 of the Complaint, this answering defendant has no information or belief sufficient to enable it to answer said allegations, and basing its denial on that ground denies each and every allegation thereof generally and specifically, and particularly denies that plaintiffs are entitled to damages in any amount whatsoever.

22. Answering the allegations of paragraph 22 of the Complaint, this answering defendant denies each and every said allegation both generally and specifically, and particularly denies that plaintiffs are entitled to exemplary or punitive damages in any amount whatsoever.

THIRD CAUSE OF ACTION

23. Answering the allegations of paragraph 23 this answering defendant realleges its answers to paragraphs 1 through 22 inclusive of the first two causes of action and

incorporates each hereby by reference as though set forth in full.

24. Answering the allegations of paragraph 24 of the Complaint, this answering defendant has no information or belief sufficient to enable it to answer said allegations, and basing its denial on that ground denies each and every allegation thereof generally and specifically.

25. Answering the allegations of paragraph 25 of the Complaint, this answering defendant denies each and every allegation thereof generally and specifically.

26. Answering the allegations of paragraph 26 of the Complaint, this answering defendant denies each and every allegation thereof generally and specifically.

27. Answering the allegations of paragraph 27 of the Complaint, defendant Fidelity denies each and every allegation thereof generally and specifically.

FIRST AFFIRMATIVE DEFENSE

28. As a first affirmative defense, these answering defendants allege that the Complaint fails to state a cause of action upon which relief can be granted.

SECOND AFFIRMATIVE DEFENSE

29. As a second affirmative defense, these answering defendants allege that Fidelity is a savings and loan association chartered under the Federal Home Owners' Loan Act of 1933 (12 U.S.C. §1461 et seq.) and is regulated thereunder and by the Federal Home Loan Bank and its regulations. By reason of its federal creation and regulation Fidelity is exempt from regulation by the State of California with respect to C.C. §711 by the doctrine of federal preemption based upon the Supremacy Clause of the United States Constitution (Art. VI, Cl. 2). Hence, plaintiffs can state no cause of action against Fidelity or any of its agents or em-

ployees acting within the scope of their business on behalf of Fidelity for any alleged violation of C.C. §711.

WHEREFORE, this answering defendant prays judgment against plaintiffs as follows:

1. That plaintiffs' prayer, for a declaration that the acceleration (due-on-sale) clause in the subject Deed of Trust is unenforceable, be denied.

2. That plaintiffs' prayer for a permanent injunction be denied.

3. That plaintiffs' further prayer for declaratory relief be denied.

4. That plaintiffs take nothing by way of damages or otherwise.

5. That this defendant be awarded reasonable attorneys fees incurred herein.

6. That this answering defendant be awarded costs of suit incurred herein, and

7. That this answering defendant be awarded such other and further relief as the Court may deem proper.

Dated: July 6, 1978

HAHN CAZIER HOEGH & LEFF
ANDREW E. KATZ
WALTER L. BLACKWELL, III
By /s/ Andrew E. Katz
Andrew E. Katz
Attorneys for Defendant
FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION AND GATEWAY MORTGAGE CORPORATION

Complaint for Declaratory Relief, Injunction and Slander of Title.

Superior Court of California, County of Orange.

Alphonso Moore and Alice Moore, Plaintiffs, vs. Fidelity Federal Savings and Loan Association, a corporation, Gateway Mortgage, a California corporation and Does 1-10, inclusive, Defendants. No. 30-63-49.

Filed: January 3, 1979.

Plaintiffs allege:

FIRST CAUSE OF ACTION

1. At all times herein mentioned, defendant Fidelity Federal Savings and Loan Association (hereinafter referred to as "Fidelity") was, and now is, a corporation, with its principal place of business in the City of Glendale, County of Los Angeles, State of California.

2. Plaintiffs are informed and believe and on that basis allege that defendant Gateway Mortgage is the trustee under that certain deed of trust, attached hereto as Exhibit "A" and more fully described in paragraph 5 hereof.

3. The true names or capacities, whether individual, corporate, associate, or otherwise, of the defendants named herein as Does 1-10, inclusive, are unknown to plaintiffs, who therefore sue said defendants by such fictitious names, and plaintiffs will amend this complaint to show their true names and capacities when same have been ascertained.

4. On or about February 22, 1978, Paul M. Stich and Debra J. Stich (hereafter referred to as "Stich") made, executed and delivered to defendant Fidelity a promissory note in the amount of $58,800.00.

5. To secure payment of the principal sum and interest as provided in the note and as part of the same transaction, Stich executed and delivered to defendant Fidelity that cer-

tain deed of trust recorded March 7, 1978, by the terms of which Stich, as trustors, conveyed to Gateway Mortgage, a California corporation, as trustee, the subject real property located at 3109 Roosevelt Way, Costa Mesa, Orange County, California. A further description of said property is set forth in said deed of trust attached hereto as Exhibit "A". Said deed of trust has remained in effect up to and including the date of filing this complaint.

6. On or about September 15, 1978, escrow closed on a transaction of purchase and sale of the real property described above. Vendor was Stich and the vendees were plaintiffs herein. A Grant Deed was recorded on the same day as Instrument No. 19323, Book 12842, Page 1370 of Orange County Records, a copy of which is attached hereto as Exhibit "B".

7. On or about December 7, 1978, defendant Fidelity, for reason of the aforesaid transfer of title to plaintiffs herein, caused to be executed and delivered to plaintiffs a Notice of Default and Election to Sell Under Deed of Trust, which is the subject of this litigation. A copy of said Notice is attached hereto as Exhibit "C" and made a part hereof by reference.

8. The subject deed of trust incorporates the following alienation clause:

> "17. Transfer of the Property; Assumption. If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Deed of Trust, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender

may, at Lender's option, declare all the sums secured by this Deed of Trust to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Deed of Trust shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17 and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Deed of Trust and the Note.

If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof."

9. The subject deed of trust also incorporates the following provision:

"15. Uniform Deed of Trust; Governing Law; Severability. This form of deed of trust combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Deed of Trust or the Note conflicts with applicable law, such conflicts shall not affect other provisions of this Deed of Trust or the Note which can be given effect without the

conflicting provision, and to this end the provisions of the Deed of Trust and the Note are declared to be severable."

10. Plaintiffs herein represent no threat to defendant's security interest and have not impaired or jeopardized defendant's security interest in any manner and no reasonable probability exists that defendant Fidelity's security interest has been or will be jeopardized to any degree by reason of said transfer of title to the plaintiffs herein.

11. Plaintiffs are informed and believe and on that basis allege that defendant's actions in enforcing the "due-on-sale" clause contained in said trust deed were not taken in concern for defendant's security interest in said real property or in concern for the creditworthiness of the plaintiffs herein, but that said actions were undertaken by defendant automatically and solely in an attempt to increase profits from said loan or the funds it represents without regard to its secured position or any particular facts or data relating to this transaction of the plaintiffs herein.

12. An actual controversy has arisen and now exists between plaintiffs and defendant Fidelity concerning their respective rights and duties, in that plaintiffs contend that the clause just alleged is unenforceable without prior showing of reason and/or justification for its use under the circumstances of this case; while defendant Fidelity contends that the clause is enforceable automatically in all cases of outright sale, and that the sale by plaintiffs' vendors of the above described real property breached the clause and entitled defendant Fidelity to payment of the total principal sum of the note alleged above, plus certain penalty fees.

13. More particularly, the controversy raises the following opposing contentions:

A. Plaintiffs contend and defendant Fidelity denies as follows:

That automatic enforcement of the alleged clause unlawfully restrains alienation as controlled by Civil Code Section 711 where the trustor's sale of the lender's security does not lessen its value or cause any threat or injury or loss to the lender. That in the circumstances of this case, the real property described above was not and will not be made less valuable as security to defendant Fidelity by its subsequent sale to plaintiffs.

That defendant Fidelity cannot contend that the sale of the real property involved in this litigation will in this case lessen its value as security since plaintiffs ask only to pay the installment obligations under the loan and trust deed alleged above.

B. Plaintiffs contend and defendant Fidelity denies that said clause is enforceable only where the beneficiary can show that his secured position has been or will be impaired or jeopardized by reason of the transfer of the security property and that said clause may not be enforced in an effort to increase profits by raising the interest rate and charging loan assumption fees and other penalties or by declaring all sums due and payable that they may be reloaned at a higher interest rate. Plaintiffs further contend and defendant denies that enforcement of the clause in an effort to increase profits from said loan or the funds it represents constitutes a restraint upon alienation for which no lawful justification exists and is a violation of public policy and California law.

C. Plaintiffs contend and defendant Fidelity denies that defendant's foreclosure proceedings are willful, intentional, deliberate, obstinate, and undertaken with malicious intent.

D. Plaintiffs contend and defendants deny that under the statutory provisions of Civil Code Sections 864 and 865, the alleged clause is invalid and unenforceable

in that the operation of said clause effectively eliminates the trustor's absolute right to transfer his property subject to an existing trust and the grantor's absolute right to take title subject to an existing trust.

14. Plaintiffs desire a judicial determination and declaration that the clause alleged above is not enforceable against them without a showing by defendant Fidelity of harm or injury to be incurred and that defendant is enjoined from foreclosing on the subject trust deed in reliance on said clause, without first showing of harm to defendant resulting from the transfer alleged in this complaint.

15. Plaintiffs have no adequate remedy at law and will suffer irreparable damage in the loss of their valuable equity in said real property. As a result of defendants' aforesaid action, plaintiffs now face the threat of the foreclosure sale on their real property unless they can raise the necessary sum required to pay off the entire loan obligation as demanded by defendant, plus the prepayment penalties and costs defendant seeks, which sum is in excess of plaintiffs' means to raise within the time allotted by defendant and applicable statutory law.

SECOND CAUSE OF ACTION

16. Plaintiffs hereby reallege paragraphs 1 through 7, inclusive, of the first cause of action and incorporate them herein as though set forth in full.

17. On or about December 7, 1978, defendant Fidelity wilfully, maliciously and without justification, published a claim that plaintiffs were in default under said trust deed, well-knowing that such claim was false. At no time herein mentioned, nor at the present time, have plaintiffs been in default respecting their obligations under said trust deed.

18. Defendants, at the time of said publication:

A. Knew and intended that such publication would be received by third parties, including, but not limited to, prospective lenders and contractors, prospective purchasers of plaintiffs' interest under the trust deed, prospective lessees of said property and portions thereof, and other members of the real estate industry.

B. Knew and intended that said third parties would understand said publication as referring to the interest of plaintiffs under the trust deed and as denying the continued existence of plaintiffs' interest or as asserting a diminution in the value thereof.

C. Knew and intended that the conduct of such third parties as prospective lenders, contractors, purchasers, and lessees would be determined by their knowledge of the matter so published.

D. Knew that the rights of plaintiffs under the trust deed were valid and subsisting, that no ground existed for claiming default of the trust deed, and that said published claim was wholly false.

19. Said claim of defendant so published was in fact understood by such third parties in the manner so intended by defendant that it be understood.

20. As a further disparagement to plaintiffs' title, defendants, on December 7, 1978, caused to be recorded a Notice of Default and Election to Sell Under Deed of Trust on the real property. In recording said instrument, defendants cast a cloud on and a slander on plaintiffs' title to the real property described herein; recording of said notice by defendant has rendered the real property unmarketable, all to the damage of said real estate and to plaintiffs in the approximate sum of $80,500.00.

21. As a further direct and proximate result of said disparagement, it has become necessary for plaintiffs to employ legal counsel to seek a judicial declaration of plain-

tiffs' rights under the trust deed, and to clear plaintiffs' said fee interest of the cloud created by said disparagement. The cost to plaintiffs of seeking such judicial declaration cannot presently be ascertained. Plaintiffs pray that, at such time as the extent of such costs can be ascertained, plaintiffs be permitted to amend this complaint to state the amount thereof.

22. The acts of said defendants, and each of them, as herein alleged, have been actuated by malice, and said defendants, and each of them, have been guilty of oppression and malice in their actions; this is a proper case for punitive damages and these plaintiffs have sustained exemplary and punitive damages in the sum of $25,000,000.00.

THIRD CAUSE OF ACTION

23. Plaintiffs hereby reallege paragraphs 1 through 14, inclusive, of the first cause of action and incorporate each hereof by reference as though set forth in full.

24. That the within action filed by plaintiffs will not come before the above entitled court for trial on the merits until after the date upon which defendant may legally hold a sale of plaintiffs' real property.

25. That the sale thereof will cause plaintiffs grievous and irreparable injury and loss, and they will be irrevocably divested of all right, title and interest in and to the real property, as well as suffering the loss of a substantial cash investment made therein pursuant to the purchase thereof.

26. That said sale of real property prior to the trial in this action will cause plaintiffs grievous and irreparable loss without affording plaintiffs opportunity to argue their case upon its merits before the above entitled court. The sale of the real property prior to adjudication will in actual fact render this action moot, leaving plaintiffs to absorb all costs

therefrom without having obtained the benefit of a court hearing.

27. To prevent said injury and harm, plaintiffs seek to temporarily enjoin defendant from any further perpetration of acts relating to or constituting a sale of the subject real property.

WHEREFORE, plaintiffs pray judgment against defendants as follows:

1. For a judicial determination and declaration that the acceleration (due-on-sale) clause in the subject trust deed is not enforceable against plaintiffs without defendant Fidelity first demonstrating harm to its security interest.

2. For a permanent injunction against any foreclosure proceedings in reliance on said clause as alleged herein.

3. For a judicial determination and declaration that defendants have maliciously impunged [sic] plaintiffs' title to the subject real property and that no default under the subject trust deed in fact exists.

4. For general damages in the sum of $80,500.00.

5. For exemplary damages in the sum of $25,000,000.00.

6. For reasonable attorney's fees incurred herein.

7. For costs of suit incurred herein.

8. For such other relief as the Court deems just.

Dated: January 29, 1979

FRED CRANE, A Professional Corporation
By /s/ Timothy Newlove
Timothy Newlove
Attorneys for plaintiffs

EXHIBIT A.

DEED OF TRUST

Book 12587, Page 1506

THIS DEED OF TRUST is made this 22nd day of February 1978, among the Trustor, Paul M. Stich and Debra J. Stich (herein "Borrower"), GATEWAY MORTGAGE CORPORATION, a California corporation (herein "Trustee"), and the Beneficiary, FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, a corporation organized and existing under the laws of The United States whose address is 600 North Brand Boulevard, Glendale, California 91203 (herein "Lender").

BORROWER, in consideration of the indebtedness herein recited and the trust herein created, irrevocably grants and conveys to Trustee, in trust, with power of sale, the following described property located in the County of Orange, State of California:

> Lot 17 of Tract 4502, in the City of Costa Mesa, County of Orange, State of California, as per map recorded in Book 183, Pages 15 and 16 of Miscellaneous Maps, in the Office of the County Recorder of said County.

which has the address of 3109 Roosevelt Way, Costa Mesa, California 92626 (herein "Property Address");

TOGETHER with all the improvements now or hereafter erected on the property, and all easements, rights, appurtenances, rents (subject however to the rights and authorities given herein to Lender to collect and apply such rents), royalties, mineral, oil and gas rights and profits, water, water rights, and water stock, and all fixtures now or hereafter attached to the property, all of which, including replacements and additions thereto, shall be deemed to be and remain a part of the property covered by this Deed of Trust; and all of the foregoing, together with said property (or the

leasehold estate in the event this Deed of Trust is on a leasehold) are herein referred to as the "Property";

TO SECURE to Lender (a) the repayment of the indebtedness evidenced by Borrower's note dated February 22, 1978 (herein "Note"), in the principal sum of 58,800.00 Dollars, with interest thereon, providing for monthly installments of principal and interest, with the balance of the indebtedness, if not sooner paid, due and payable on March 1, 2008; the payment of all other sums, with interest thereon, advanced in accordance herewith to protect the security of this Deed of Trust; and the performance of the covenants and agreements of Borrower herein contained, and (b) the repayment of any future advances, with interest thereon, made to Borrower by Lender pursuant to paragraph 21 hereof "Future Advances".

Borrower covenants that Borrower is lawfully seised of the estate hereby conveyed and has the right to grant and convey the Property, that the Property is unencumbered, and that Borrower will warrant and defend generally the title to the Property against all claims and demands, subject to any declarations, easements or restrictions listed in a schedule of exceptions to coverage in any title insurance policy insuring Lender's interest in the Property.

UNIFORM COVENANTS. Borrower and Lender covenant and agree as follows:

1. Payment of Principal and Interest. Borrower shall promptly pay when due the principal of and interest on the indebtedness evidenced by the Note, prepayment and late charges as provided in the Note, and the principal of and interest on any Future Advances secured by this Deed of Trust.

2. Funds for Taxes and Insurance. Subject to applicable law or to a written waiver by Lender, Borrower shall pay

to Lender on the day monthly installments of principal and interest are payable under the Note, until the Note is paid in full, a sum (herein "Funds") equal to one-twelfth of the yearly taxes and assessments which may attain priority over this Deed of Trust, and ground rents on the Property, if any, plus one-twelfth of yearly premium installments for hazard insurance, plus one-twelfth of yearly premium installments for mortgage insurance, if any, all as reasonably estimated initially and from time to time by Lender on the basis of assessments and bills and reasonable estimates thereof.

The Funds shall be held in an institution the deposits or accounts of which are insured or guaranteed by a Federal or state agency (including Lender if Lender is such an institution). Lender shall apply the Funds to pay said taxes, assessments, insurance premiums and ground rents. Lender may not charge for so holding and applying the Funds, analyzing said account or verifying and compiling said assessments and bills, unless Lender pays Borrower interest on the Funds and applicable law permits Lender to make such a charge. Borrower and Lender may agree in writing at the time of execution of this Deed of Trust that interest on the Funds shall be paid to Borrower, and unless such agreement is made or applicable law requires such interest to be paid. Lender shall not be required to pay Borrower any interest or earnings on the Funds. Lender shall give to Borrower, without charge, an annual accounting of the Funds showing credits and debits to the Funds and the purpose for which each debit to the Funds was made. The Funds are pledged as additional security for the sums secured by this Deed of Trust.

If the amount of the Funds held by Lender, together with the future monthly installments of Funds payable prior to the due dates of taxes, assessments, insurance premiums

and ground rents, shall exceed the amount required to pay said taxes, assessments, insurance premiums and ground rents as they fall due, such excess shall be, at Borrower's option, either promptly repaid to Borrower or credited to Borrower on monthly installments of Funds. If the amount of the Funds held by Lender shall not be sufficient to pay taxes, assessments, insurance premiums and ground rents as they fall due, Borrower shall pay to Lender any amount necessary to make up the deficiency within 30 days from the date notice is mailed by Lender to Borrower requesting payment thereof.

Upon payment in full of all sums secured by this Deed of Trust, Lender shall promptly refund to Borrower any Funds held by Lender. If under paragraph 18 hereof the Property is sold or the Property is otherwise acquired by Lender, Lender shall apply, no later than immediately prior to the sale of the Property or its acquisition by Lender, any Funds held by Lender at the time of application as a credit against the sums secured by this Deed of Trust.

3. Application of Payments. Unless applicable law provides otherwise, all payments received by Lender under the Note and paragraphs 1 and 2 hereof shall be applied by Lender first in payment of amounts payable to Lender by Borrower under paragraph 2 hereof, then to interest payable on the Note, then to the principal of the Note, and then to interest and principal on any Future Advances.

4. Charges; Liens. Borrower shall pay all taxes, assessments and other charges, fines and impositions attributable to the Property which may attain a priority over this Deed of Trust, and leasehold payments or ground rents, if any, in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the payee thereof. Borrower shall promptly furnish to Lender all notices of amounts due under

this paragraph, and in the event Borrower shall make payment directly, Borrower shall promptly furnish to Lender receipts evidencing such payments. Borrower shall promptly discharge any lien which has priority over this Deed of Trust; provided, that Borrower shall not be required to discharge any such lien so long as Borrower shall agree in writing to the payment of the obligation secured by such lien in a manner acceptable to Lender, or shall in good faith contest such lien by, or defend enforcement of such lien in, legal proceedings which operate to prevent the enforcement of the lien or forfeiture of the Property or any part thereof.

5. *Hazard Insurance*. Borrower shall keep the improvements now existing or hereafter erected on the property insured against loss by fire, hazards included within the term "extended coverage", and such other hazards as Lender may require and in such amounts and for such periods as Lender may require; provided, that Lender shall not require that the amount of such coverage exceed that amount of coverage required to pay the sums secured by this Deed of Trust.

The insurance carrier providing the insurance shall be chosen by Borrower subject to approval by Lender; provided, that such approval shall not be unreasonably withheld. All premiums on insurance policies shall be paid in the manner provided under paragraph 2 hereof or, if not paid in such manner, by Borrower making payment, when due, directly to the insurance carrier.

All insurance policies and renewals thereof shall be in form acceptable to Lender and shall include a standard mortgage clause in favor of and in form acceptable to Lender. Lender shall have the right to hold the policies and renewals thereof, and Borrower shall promptly furnish to Lender all renewal notices and all receipts of paid premiums. In the event of loss, Borrower shall give prompt notice to

the insurance carrier and Lender. Lender may make proof of loss if not made promptly by Borrower.

Unless Lender and Borrower otherwise agree in writing, insurance proceeds shall be applied to restoration or repair of the Property damaged, provided such restoration or repair is economically feasible and the security of this Deed of Trust is not thereby impaired. If such restoration or repair is not economically feasible or if the security of this Deed of Trust would be impaired, the insurance proceeds shall be applied to the sums secured by this Deed of Trust, with the excess, if any, paid to Borrower. If the property is abandoned by Borrower, of if Borrower fails to respond to Lender within 30 days from the date notice is mailed by Lender to Borrower that the insurance carrier offers to settle a claim for insurance benefits, Lender is authorized to collect and apply the insurance proceeds at Lender's option either to restoration or repair of the Property or to the sums secured by this Deed of Trust.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments. If under paragraph 18 hereof the property is acquired by Lender, all right, title and interest of Borrower in and to any insurance policies and in and to the proceeds thereof resulting from damage to the Property prior to the sale or acquisition shall pass to Lender to the extent of the sums secured by this Deed of Trust immediately prior to such sale or acquisition.

6. *Preservation and Maintenance of property; Leaseholds; Condominiums; Planned Unit Developments.* Borrower shall keep the Property in good repair and shall not commit waste or permit impairment or deterioration of the

Property and shall comply with the provisions of any lease if this Deed of Trust is on a leasehold. If this Deed of Trust is on a unit in a condominium or a planned unit development, Borrower shall perform all of Borrower's obligations under the declaration or covenants creating or governing the condominium or planned unit development, the by-laws and regulations of the condominium or planned unit development, and constituent documents. If a condominium or planned unit development rider is executed by Borrower and recorded together with this Deed of Trust, the covenants and agreements of such rider shall be incorporated into and shall amend and supplement the covenants and agreements of this Deed of Trust as if the rider were a part hereof.

7. *Protection of Lender's Security.* If Borrower fails to perform the covenants and agreements contained in this Deed of Trust, or if any action or proceeding is commenced which materially affects Lender's interest in the property, including, but not limited to, eminent domain, insolvency, code enforcement, or arrangements or proceedings involving a bankrupt or decedent, then Lender at Lender's option, upon notice to Borrower, may make such appearances, disburse such sums and take such action as is necessary to protect Lender's interest, including, but not limited to disbursement of reasonable attorney's fees and entry upon the property to make repairs. If Lender required mortgage insurance as a condition of making the loan secured by this Deed of Trust, Borrower shall pay the premiums required to maintain such insurance in effect until such time as the requirement for such insurance terminates in accordance with Borrower's and Lender's written agreement or applicable law. Borrower shall pay the amount of all mortgage insurance premiums in the manner provided under paragraph 2 hereof.

Any amounts disbursed by Lender pursuant to this paragraph 7, with interest thereon, shall become additional indebtedness of Borrower secured by this Deed of Trust. Unless Borrower and Lender agree to other terms of payment, such amounts shall be payable upon notice from Lender to Borrower requesting payment thereof, and shall bear interest from the date of disbursement at the rate payable from time to time on outstanding principal under the Note unless payment of interest at such rate would be contrary to applicable law, in which event such amounts shall bear interest at the highest rate permissible under applicable law. Nothing contained in this paragraph 7 shall require Lender to incur any expense or take any action hereunder.

8. *Inspection*. Lender may make or cause to be made reasonable entries upon and inspections of the property, provided that Lender shall give Borrower notice prior to any such inspection specifying reasonable cause therefor related to Lender's interest in the Property.

9. *Condemnation*. The proceeds of any award or claim for damages, direct or consequential, in connection with any condemnation or other taking of the Property, or part thereof, or for conveyance in lieu of condemnation, are hereby assigned and shall be paid to Lender.

In the event of a total taking of the Property, the proceeds shall be applied to the sums secured by this Deed of Trust, with the excess, if any, paid to Borrower. In the event of a partial taking of the Property, unless Borrower and Lender otherwise agree in writing, there shall be applied to the sums secured by this Deed of Trust such proportion of the proceeds as is equal to that proportion which the amount of the sums secured by this Deed of Trust immediately prior to the date of taking bears to the fair market value of the property immediately prior to the date of taking, with the balance of the proceeds paid to Borrower.

If the property is abandoned by Borrower, or if, after notice by Lender to Borrower that the condemnor offers to make an award or settle a claim for damages. Borrower fails to respond to Lender within 30 days after the date such notice is mailed, Lender is authorized to collect and apply the proceeds, at Lender's option, either to restoration on repair of the Property or to the sums secured by this Deed of Trust.

Unless Lender and Borrower otherwise agree in writing, any such application of proceeds to principal shall not extend or postpone the due date of the monthly installments referred to in paragraphs 1 and 2 hereof or change the amount of such installments.

10. Borrower Not Released. Extension of the time for payment or modification of amortization of the sums secured by this Deed of Trust granted by Lender to any successor in interest of Borrower shall not operate to release, in any manner, the liability of the original Borrower and Borrower's successors in interest. Lender shall not be required to commence proceedings against such successor or refuse to extend time for payment or otherwise modify amortization of the sums secured by this Deed of Trust by reason of any demand made by the original Borrower and Borrower's successors in interest.

11. Forbearance by Lender Not a Waiver. Any forbearance by Lender in exercising any right or remedy hereunder, or otherwise afforded by applicable law, shall not be a waiver of or preclude the exercise of any such right or remedy. The procurement of insurance or the payment of taxes or other liens or charges by Lender shall not be a waiver of Lender's right to accelerate the maturity of the indebtedness secured by this Deed of Trust.

12. Remedies Cumulative. All remedies provided in this Deed of Trust are distinct and cumulative to any other right or remedy under this Deed of Trust or afforded by law or equity, and may be exercised concurrently, independently or successively.

13. Successors and Assigns Bound; Joint and Several Liability; Captions. The covenants and agreements herein contained shall bind, and the rights hereunder shall inure to, the respective successors and assigns of Lender and Borrower, subject to the provisions of paragraph 17 hereof. All covenants and agreements of Borrower shall be joint and several. The captions and headings of the paragraphs of this Deed of Trust are for convenience only and are not to be used to interpret or define the provisions hereof.

14. Notice. Except for any notice required under applicable law to be given in another manner, (a) any notice to Borrower provided for in this Deed of Trust shall be given by mailing such notice by certified mail addressed to Borrower at the Property Address or at such other address as Borrower may designate by notice to Lender as provided herein, and (b) any notice to Lender shall be given by certified mail, return receipt requested, to Lender's address stated herein or to such other address as Lender may designate by notice to Borrower as provided herein. Any notice provided for in this Deed of Trust shall be deemed to have been given to Borrower or Lender when given in the manner designated herein.

15. Uniform Deed of Trust; Governing Law; Severability. This form of deed of trust combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision

or clause of this Deed of Trust or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Deed of Trust or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Deed of Trust and the Note are declared to be severable.

16. Borrower's Copy. Borrower shall be furnished a conformed copy of the Note and of this Deed of Trust at the time of execution or after recordation hereof.

17. Transfer of the Property; Assumption. If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Deed of Trust, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this Deed of Trust to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Deed of Trust shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Deed of Trust and the Note.

If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of

not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof.

NON-UNIFORM COVENANTS. Borrower and Lender further covenant and agree as follows:

18. Acceleration; Remedies. Except as provided in paragraph 17 hereof, upon Borrower's breach of any covenant or agreement of Borrower in this Deed of Trust, including the covenants to pay when due any sums secured by this Deed of Trust, Lender prior to acceleration shall mail notice to Borrower as provided in paragraph 14 hereof specifying: (1) the breach; (2) the action required to cure such breach; (3) a date, not less than 30 days from the date of the notice is mailed to Borrower, by which such breach must be cured; and (4) that failure to cure such breach on or before the date specified in the notice may result in acceleration of the sums secured by this Deed of Trust and sale of the Property. The notice shall further inform Borrower of the right to reinstate after acceleration and the right to bring a court action to assert the nonexistence of a default or any other defense of Borrower to acceleration and sale. If the breach is not cured on or before the date specified in the notice, Lender at Lender's option may declare all of the sums secured by this Deed of Trust to be immediately due and payable without further demand and may invoke the power of sale and any other remedies permitted by applicable law. Lender shall be entitled to collect all reasonable costs and expenses incurred in pursuing the remedies provided in this paragraph 18, including, but not limited to, reasonable attorney's fees.

If Lender invokes the power of sale, Lender shall execute or cause Trustee to execute a written notice of the occurrence of an event of default and of Lender's election to cause the Property to be sold and shall cause such notice to be recorded in each county in which the Property or some part thereof is located. Lender or Trustee shall mail copies of such notice in the manner prescribed by applicable law to Borrower and to the other persons prescribed by applicable law. Trustee shall give public notice of sale to the persons and in the manner prescribed by applicable law. After the lapse of such time as may be required by applicable law, Trustee, without demand on Borrower, shall sell the property at public auction to the highest bidder at the time and place and under the terms designated in the notice of sale in one or more parcels and in such order as Trustee may determine. Trustee may postpone sale of all or any parcel of the Property by public announcement at the time and place of any previously scheduled sale. Lender or Lender's designee may purchase the Property at any sale.

Trustee shall deliver to the purchaser Trustee's deed conveying the Property so sold without any covenant or warranty, expressed or implied. The recitals in the Trustee's deed shall be prima facie evidence of the truth of the statements made therein. Trustee shall apply the proceeds of the sale in the following order: (a) to all reasonable costs and expenses of the sale, including, but not limited to, reasonable Trustee's and attorney's fees and costs of title evidence; (b) to all sums secured by this Deed of Trust; and (c) the excess, if any, to the person or persons legally entitled thereto.

19. Borrower's Right to Reinstate. Notwithstanding Lender's acceleration of the sums secured by this Deed of Trust, Borrower shall have the right to have any proceedings begun by Lender to enforce this Deed of Trust discontinued

at any time prior to five days before sale of the property pursuant to the power of sale contained in this Deed of Trust or at any time prior to entry of a judgment enforcing this Deed of Trust if: (a) Borrower pays Lender all sums which would be then due under this Deed of Trust, the Note and notes securing Future Advances, if any, had no acceleration occurred, (b) Borrower cures all breaches of any other covenants or agreements of Borrower contained in this Deed of Trust; (c) Borrower pays all reasonable expenses incurred by Lender and Trustee in enforcing the covenants and agreements of Borrower contained in this Deed of Trust, and in enforcing Lender's and Trustee's remedies as provided in paragraph 18 hereof, including, but not limited to, reasonable attorney's fees; and (d) Borrower takes such action as Lender may reasonably require to assure that the lien of this Deed of Trust, Lender's interest in the Property and Borrower's obligation to pay the sums secured by this Deed of Trust shall continue unimpaired. Upon such payment and cure by Borrower, this Deed of Trust and the obligations secured hereby shall remain in full force and effect as if no acceleration had occurred.

20. Assignment of Rents; Appointment of Receiver; Lender in Possession. As additional security hereunder, Borrower hereby assigns to Lender the rents of the Property, provided that Borrower shall, prior to acceleration under paragraph 18 hereof or abandonment of the Property, have the right to collect and retain such rents as they become due and payable.

Upon acceleration under paragraph 18 hereof or abandonment of the Property, Lender, in person, by agent or by judicially appointed receiver shall be entitled to enter upon, take possession of and manage the Property and to collect the rents of the Property including those past due. All rents collected by Lender or the receiver shall be applied first to

payment of the costs of management of the Property and collection of rents, including, but not limited to, receiver's fees, premiums on receiver's bonds and reasonable attorney's fees, and then to the sums secured by this Deed of Trust. Lender and the receiver shall be liable to account only for those rents actually received.

21. Future Advances. Upon request of Borrower, Lender, at Lender's option prior to full reconveyance of the Property by Trustee to Borrower, may make Future Advances to Borrower. Such Future Advances, with interest thereon, shall be secured by this Deed of Trust when evidenced by promissory notes stating that said notes are secured hereby.

22. Reconveyance. Upon payment of all sums secured by this Deed of Trust, Lender shall request Trustee to reconvey the Property and shall surrender this Deed of Trust and all notes evidencing indebtedness secured by this Deed of Trust to Trustee. Trustee shall reconvey the Property without warranty and without charge to the person or persons legally entitled thereto. Such person or persons shall pay all costs of recordation, if any.

23. Substitute Trustee. Lender, at Lender's option, may from time to time remove Trustee and appoint a successor trustee to any Trustee appointed hereunder. Without conveyance of the Property, the successor trustee shall succeed to all the title, power and duties conferred upon the Trustee herein and by applicable law.

24. Request for Notices. Borrower requests that copies of the notice of default and notice of sale be sent to Borrower's address which is the Property Address.

25. Statement of Obligation. Lender may collect a fee not to exceed $15 for furnishing the statement of obligation as provided by Section 2943 of the Civil Code of California.

IN WITNESS WHEREOF, Borrower has executed this Deed of Trust.

/s/ Paul M. Stich
Paul M. Stich Borrower

/s/ Debra J. Stich
Debra J. Stich Borrower

State of California, Orange County ss:

On this 1st day of March, 1978, before me, the undersigned, a Notary Public in and for said State, personally appeared Paul M. Stich and Debra J. Stich, known to me to be the person(s) whose name(s) are subscribed to the foregoing instrument and acknowledged that they executed the same.

Signature: /s/ Cindi L. Garman
Cindi L. Garman

REQUEST FOR RECONVEYANCE

TO TRUSTEE:

The undersigned is the holder of the note or notes secured by this Deed of Trust. Said note or notes, together with all other indebtedness secured by its Deed of Trust, have been paid in full. You are hereby directed to cancel said note or notes and this Deed of Trust, which are delivered hereby, and to reconvey, without warranty, all the estate now held by you under this Deed of Trust to the person or persons legally entitled thereto.

Dated: February 8, 1980

/s/ Barbara M. Breeden
Asst. Vice President

/s/ Herbert G. Gammill
Asst. Secretary

EXHIBIT B.

GRANT DEED
AP #141-693-24
Book 1284, Page 1370

FOR A VALUABLE CONSIDERATION, receipt of which is hereby acknowledged,

PAUL M. STICH AND DEBRA J. STICH

hereby GRANTS TO

ALPHONSO MOORE AND ALICE MOORE, HUSBAND AND WIFE, AS JOINT TENANTS

the following described real property in the County of Orange, CITY OF COSTA MESA, State of California:

LOT 17 OF TRACT NO. 4502 AS PER MAP RECORDED IN BOOK 183, PAGES 15 AND 16 OF MISCELLANEOUS MAPS IN THE OFFICE OF THE COUNTY RECORDER OF SAID ORANGE COUNTY.

Dated AUGUST 22, 1978

/s/ Paul M. Stich
PAUL M. STICH

/s/ Debra J. Stich
DEBRA J. STICH

State of California County of Orange — ss.

On August 23, 1978, before me, the undersigned, a Notary Public in and for said State, personally appeared Paul M. Stich and Debra J. Stich, known to me to be the person(s) whose name(s) subscribed to the within instrument and acknowledged that they executed the same.

WITNESS my hand and
official seal.
Signature (ILLEGIBLE)
Notary Public in and for
said State,
Title Order No 1390321: Escrow No 102.

EXHIBIT C.

Notice of Default and Election to
Sell Under Deed of Trust
Book 12970, Page 278

NOTICE IS HEREBY GIVEN: That GATEWAY MORTGAGE CORPORATION a California corporation, is Trustee, successor Trustee or substituted Trustee, under a Deed of Trust dated February 22, 1978, executed by Paul M. Stich and Debra J. Stich as Trustor to secure certain obligations including one note(s) in the amount of $58,800.00 in favor of FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, a corporation, Beneficiary, recorded as Instrument No. 7263 on March 7, 1978 in Book 12587, Page 1506 of Official Records in the office of the County Recorder of Orange County, California.

Lot 17 of Tract 4502, in the City of Costa Mesa, County of Orange, State of California, as per map recorded in Book 183, Pages 15 and 16 of Miscellaneous Maps, in the Office of the County Recorder of said County.

That the beneficial interest under such Deed and the obligations secured thereby have not been transferred or assigned;

that a breach of, and default in, the obligations secured by said Deed of Trust have occurred in that payment has not been made of:

SEE EXHIBIT "A" ATTACHED HERETO

That by reason thereof the undersigned, the present Beneficiary under said Deed of Trust, has executed and delivered to said Trustee a written Declaration of Default and demand for sale, and has surrendered to said Trustee such Deed and all documents evidencing obligations secured thereby, and has declared and does hereby declare all sums secured

thereby immediately due and has elected, and does hereby elect, to cause the trust property to be sold to satisfy the obligations secured thereby.

Dated: December 7, 1978

Fidelity Federal Savings and Loan Association,
A corporation formerly known as Fidelity Federal
Savings and Loan Association of Glendale, a corporation.

(Seal)

By/s/ Catherine Derieg
Catherine Derieg, Vice President

By/s/ Barbara M. Breeden
Barbara M. Breeden, Assistant Secretary

NOTICE: You may have the right to cure the default described herein and reinstate the mortgage or deed of trust. Section 2924c of the Civil Code permits certain defaults to be cured upon the payment of the amounts required by that section without requiring payment of that portion of the principal and interest which would not be due had no default occurred. Where reinstatment is possible, if the default is not cured within three months following the recording of this notice, the right of reinstatement will terminate and the property may be sold.

To determine if reinstatment is possible and the amount, if any, necessary to cure the default, contact the beneficiary or mortgagee or their successors in interest, whose name and address as of the date of this notice is—

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION
600 NORTH BRAND BLVD., GLENDALE, CALIF. 91203

EXHIBIT "A"

That a breach of, and default in, the obligations secured by said Deed of Trust have occured in that a violation of the Acceleration Clause as contained in the Deed of Trust occured [sic] in that "If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, . . . Lender may, at Lender's option, declare all the sums secured by this Deed of Trust to be immediately due and payable;" i.e., "The Trustor sold, conveyed, transferred, or disposed of said property without the written consent of the Beneficiary being first had and obtained," and therefore, the Beneficiary has declared all sums secured thereby forewith [sic] due and payable.

Payment has not been made of the installment of principal and interest which became due on September 1, 1978, and all subsequent installments of principal and interest, the late charges for all delinquent principal and interest installments aforementioned, if any, along with late charges, foreclosure costs, legal fees, or advances that may become due.

Answer and Affirmative Defenses.

Superior Court of the State of California for the County of Orange.

Alphonso Moore and Alice Moore, Plaintiffs, v. Fidelity Federal Savings & Loan Association, a corporation, Gateway Mortgage Corporation, a California corporation, and Does 1-10, inclusive, Defendants. No. 30-63-49.

Filed: April 2, 1979.

Defendants Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation (herein collectively "Fidelity Federal") answer plaintiffs' complaint for themselves alone as follows:

FIRST CAUSE OF ACTION

1. Fidelity Federal admits the allegations contained in paragraph 1 of the plaintiffs' complaint.

2. Fidelity Federal admits the allegations contained in paragraph 2 of the plaintiffs' complaint.

3. Fidelity Federal is without sufficient knowledge or information to form a belief as to the truth of the allegations contained in paragraph 3 of the plaintiffs' complaint and therefore, on that basis, denies each and every allegation contained therein.

4. Fidelity Federal admits the allegations contained in paragraph 4 of the plaintiffs' complaint.

5. Fidelity Federal admits the allegations contained in paragraph 5 of the plaintiffs' complaint.

6. Fidelity Federal admits the allegations contained in paragraph 6 of the plaintiffs' complaint.

7. Fidelity Federal admits the allegations contained in paragraph 7 of the plaintiffs' complaint.

8. Fidelity Federal admits the allegations contained in paragraph 8 of the plaintiffs' complaint.

9. Fidelity Federal admits the allegations contained in paragraph 9 of the plaintiffs' complaint.

10. Fidelity Federal is without sufficient knowledge or information to form a belief as to the truth of the allegations contained in paragraph 10 of the plaintiffs' complaint and therefore, on that basis, denies each and every allegation contained therein.

11. Fidelity Federal denies each and every allegation contained in paragraph 11 of the plaintiffs' complaint.

12. Fidelity Federal admits the allegations contained in paragraph 12 of the plaintiffs' complaint.

13. Fidelity Federal is without sufficient knowledge or information to form a belief as to the truth of the allegations contained in paragraph 13 of the plaintiffs' complaint and therefore, on that basis, denies each and every allegation contained therein.

14. Fidelity Federal denies each and every allegation contained in paragraph 14 of the plaintiffs' complaint.

15. Fidelity Federal denies each and every allegation contained in paragraph 15 of the plaintiffs' complaint.

SECOND CAUSE OF ACTION

16. Fidelity Federal refers to and realleges its answers to paragraphs 1 through 7 inclusive of the plaintiffs' complaint and incorporates those paragraphs herein by this reference as its answer to paragraph 16 of the plaintiffs' complaint.

17. Fidelity Federal admits that it claims that plaintiff is in default. Except as expressly admitted herein, defendant Fidelity Federal denies each and every remaining allegation contained in paragraph 17 of the plaintiffs' complaint.

18. Fidelity Federal denies each and every allegation contained in paragraph 18 of the plaintiffs' complaint.

19. Fidelity Federal denies each and every allegation contained in paragraph 19 of the plaintiffs' complaint.

20. Fidelity Federal admits that it recorded and served a Notice of Default and Election to Sell with respect to the

subject property. Except as expressly admitted herein, Fidelity Federal denies each and every remaining allegation contained in paragraph 20 of the plaintiffs' complaint and specifically denies that plaintiffs have been damaged in the sum of $80,500.00 or any other amount whatsoever.

21. Fidelity Federal denies each and every allegation contained in paragraph 21 of the plaintiffs' complaint.

22. Fidelity Federal denies each and every allegation contained in paragraph 22 of the plaintiffs' complaint and specifically denies that plaintiff is entitled to punitive damages in the sum of $25,000,000.00 or any other amount whatsoever.

THIRD CAUSE OF ACTION

23. Fidelity Federal refers to and realleges its answers to paragraphs 1 through 14 inclusive of the plaintiffs' complaint and incorporates those paragraphs herein by this reference as its answer to paragraph 23 of the plaintiffs' complaint.

24. Fidelity Federal admits the allegations contained in paragraph 24 of the plaintiffs' complaint.

25. Fidelity Federal denies each and every allegation contained in paragraph 25 of the plaintiffs' complaint.

26. Fidelity Federal denies each and every allegation contained in paragraph 26 of the plaintiffs' complaint.

27. Fidelity Federal denies each and every allegation contained in paragraph 27 of the plaintiffs' complaint.

FIRST AFFIRMATIVE DEFENSE

28. Plaintiffs' complaint fails to state sufficient facts to constitute a cause of action against these answering defendants.

SECOND AFFIRMATIVE DEFENSE

29. Fidelity Federal Savings and Loan Association is a federally chartered savings and loan association governed by the statutes of the United States and rules, regulations, and policies of the Federal Home Loan Bank Board as announced, adopted, or declared by the Bank Board pursuant to its statutory authority to regulate each and every aspect of the business of federal savings and loan associations on a nationally uniform basis. Pursuant to its statutory authority, the Federal Home Loan Bank Board has the power to authorize federal savings and loan associations to include within its notes and deeds of trust and to automatically enforce due-on-sale clauses. At all times relevant herein, the Federal Home Loan Bank Board has so exercised its statutory authority so as to preclude any attempted regulation by state authorities, whether by statute or court decision, from prohibiting federal savings and loan associations such as Fidelity Federal from automatically exercising due-on-sale clauses in notes and deeds of trust given in favor of Fidelity Federal as beneficiary with respect to loans secured by real property. By federal preemption under the supremacy clause of the United States Constitution, this Court is precluded from entering any finding that Fidelity Federal has violated Civil Code §711 or any other State enactment or policy pertaining to restraints on alienation by reason of Fidelity Federal's enforcement of the due-on-sale clause in the note and deed of trust given in favor of Fidelity Federal.

WHEREFORE, defendants Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation pray for judgment as follows:

1. That plaintiffs take nothing by their complaint and that should any declaration be issued, that such declaration be that Fidelity Federal as a federally chartered savings and

loan association is exempt from the operation of Civil Code §711 by reason of preemption under the supremacy clause of the United States Constitution.

2. For costs of suit.

3. For reasonable attorneys' fees.

4. For such other and further relief as this Court may deem just and proper.

DATED: March 14, 1979.

HAHN CAZIER & LEFF
WALTER L. BLACKWELL, III
By /s/ Andrew E. Katz
Andrew E. Katz
Attorneys for defendants
Fidelity Federal Savings and
Loan Association and Gateway
Mortgage Corporation

Complaint for Declaratory Relief, Injunction and Slander of Title.

Superior Court of California, County of Orange.

John D. Whitcombe, Plaintiff, vs. Fidelity Federal Savings and Loan Association, a corporation, Gateway Mortgage Corporation, a California corporation, and Does 1-10, inclusive, Defendants. No. 30-85-27.

Filed: March 5, 1979.

Plaintiffs allege:

FIRST CAUSE OF ACTION

1. At all times herein mentioned, defendant Fidelity Federal Savings and Loan Association (hereinafter "Fidelity") was, and now is, a corporation, with its principal place of business in the County of Los Angeles, City of Glendale, California.

2. Plaintiffs are informed and believe and on that basis allege that defendant Gateway Mortgage Corporation is the trustee under that certain deed of trust, attached hereto as Exhibit "A" and more fully described in paragraph 5 hereof.

3. The true names or capacities, whether individual, corporate, associate, or otherwise, of the defendants named herein as Does 1 - 10, inclusive, are unknown to plaintiffs, who therefore sue said defendants by such fictitious names, and plaintiffs will amend this complaint to show their true names and capacities when same have been ascertained.

4. On or about July 17, 1972, Carter Wood and Irene R. Wood (hereinafter "Wood") made, executed and delivered to defendant Fidelity a promissory note in the amount of $29,200.00

5. To secure payment of the principal sum and interest as provided in the note and as part of the same transaction,

Flynn executed and delivered to defendant Fidelity that certain deed of trust recorded July 28, 1972, by the terms of which Wood, as trustors, conveyed to Gateway Mortgage Corporation, a California corporation, as trustee, the subject real property located at 7392 Natal Drive, Westminster, Orange County, California. A further description of said property is set forth in said deed of trust attached hereto as Exhibit "A". Said deed of trust has remained in effect up to and including the date of filing this complaint.

6. On or about November 9, 1978, escrow closed on a transaction of purchase and sale of the real property described above. Vendor was Wood and the vendees were plaintiffs herein. A Grant Deed was recorded on the same day as Instrument No. 13248 of Orange County records, a copy of which is attached hereto as Exhibit "B".

7. On or about December 29, 1978, defendant Fidelity, for reason of the aforesaid transfer of title to plaintiffs herein, caused to be executed and delivered to plaintiffs a Notice of Default and Election to Sell under Deed of Trust, which is the subject of this litigation. A copy of said notice is attached hereto as Exhibit "C" and made a part hereof by reference.

8. The subject deed of trust incorporates the following alienation clause:

> "17. TRANSFER OF THE PROPERTY: ASSUMPTION. If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Deed of Trust, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option

to purchase, Lender may, at Lender's option, declare all the sums secured by this Deed of Trust to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Deed of Trust shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17 and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Deed of Trust and the Note.

If Lender exercises such option to accelerate, Lender shall mail Borrower notice of acceleration in accordance with paragraph 14 hereof. Such notice shall provide a period of not less than 30 days from the date the notice is mailed within which Borrower may pay the sums declared due. If Borrower fails to pay such sums prior to the expiration of such period, Lender may, without further notice or demand on Borrower, invoke any remedies permitted by paragraph 18 hereof."

9. The subject deed of trust also incorporates the following provision:

"15. UNIFORM DEED OF TRUST; GOVERNING LAW; SEVERABILITY. This form of deed of trust combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Deed of Trust or the Note conflicts with

applicable law, such conflicts shall not affect other provisions of this Deed of Trust or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Deed of Trust and the Note are declared to be severable."

10. Plaintiffs herein represent no threat to defendant's security interest and have not impaired or jeopardized defendant's security interest in any manner and no reasonable probability exists that defendant Fidelity's security interest has been or will be jeopardized to any degree by reason of said transfer of title to the plaintiffs herein.

11. Plaintiffs are informed and believe and on that basis allege, that defendant's actions in enforcing the "due-on-sale" clause contained in said trust deed were not taken in concern for defendant's security interest in said real property or in concern for the credit worthiness of the plaintiffs herein, but that said actions were undertaken by defendant automatically and solely in an attempt to increase profits from said loan or the funds it represents without regard to its secured position or any particular facts or data relating to this transaction of the plaintiffs herein.

12. An actual controversy has arisen and now exists between plaintiffs and defendant Fidelity concerning their respective rights and duties, in that plaintiffs contend that the clause just alleged is unenforceable without prior showing of reason and/or justification for its use under the circumstances of this case; while defendant Fidelity contends that the clause is enforceable automatically and in all cases of outright sale, and that the sale by plantiffs' vendors of the above described real property breached the clause and entitled defendant Fidelity to payment of the total principal sum of the note alleged above, plus certain penalty fees.

13. More particularly, the controversy raises the following opposing contentions:

A. Plaintiffs contend and defendant Fidelity denies as follows:

That automatic enforcement of the alleged clause unlawfully restrains alienation as controlled by Civil Code Section 711 where the trustor's sale of the lender's security does not lessen its value or cause any threat or injury or loss to the lender. That in the circumstances of this case, the real property described above was not and will not be made less valuable as security to defendant Fidelity by its subsequent sale to plaintiffs.

That defendant Fidelity cannot contend that the sale of the real property involved in this litigation will in this case lessen its value as security since plaintiffs ask only to pay the installment obligation under the loan and trust deed alleged above.

B. Plaintiffs contend and defendant Fidelity denies that said clause is enforceable only where the beneficiary can show that his secured position has been or will be impaired or jeopardized by reason of the transfer of the security property and that said clause may not be enforced in an effort to increase profits by raising the interest rate and charging loan assumption fees and other penalties or by declaring all sums due and payable that they may be reloaned at a higher interest rate. Plaintiffs further contend and defendant denies that enforcement of the clause in an effort to increase profits from said loan or the funds it represents constitutes a restraint upon alienation for which no lawful justification exists and is a violation of public policy and California law.

C. Plaintiffs contend and defendant Fidelity denies that defendant's foreclosure proceedings are willful, intentional, deliberate, obstinate, and undertaken with malicious intent.

D. Plaintiffs contend and defendants deny that under the statutory provisions of Civil Code Sections 864 and 865, the alleged clause is invalid and unenforceable in that the operation of said clause effectively eliminates the trustor's absolute right to transfer his property subject to an existing trust and the grantor's absolute right to take title subject to an existing trust.

14. Plaintiffs desire a judicial determination and declaration that the clause alleged above is not enforceable against them without a showing by defendant Fidelity of harm or injury to be incurred and that defendant is enjoined from foreclosing on the subject trust deed in reliance on said clause, without first showing of harm to defendant resulting from the transfer alleged in this complaint.

15. Plaintiffs have no adequate remedy at law and will suffer irreparable damage in the loss of their valuable equity in said real property. As a result of defendant's aforesaid action, plaintiffs now face the threat of the foreclosure sale on their real property unless they can raise the necessary sum required to pay off the entire loan obligation as demanded by defendant, plus the prepayment penalties and costs defendant seeks, which sum is in excess of plaintiffs' means to raise within the time allotted by defendant and applicable statutory law.

SECOND CAUSE OF ACTION

16. Plaintiffs hereby reallege paragraphs 1 through 7, inclusive, of the first cause of action and incorporate them herein as though set forth in full.

17. On or about December 29, 1978, defendant Fidelity wilfully, maliciously and without justification, published a claim that plaintiffs were in default under said trust deed, well-knowing that such claim was false. At no time herein

mentioned, nor at the present time, have plaintiffs been in default respecting their obligations under said trust deed.

18. Defendants, at the time of said publication:

A. Knew and intended that such publication would be received by third parties, including, but not limited to, prospective lenders and contractors, prospective purchasers of plaintiffs' interest under the trust deed, prospective lessees of said property and portions thereof, and other members of the real estate industry.

B. Knew and intended that said third parties would understand said publication as referring to the interest of plaintiffs under the trust deed and as denying the continued existence of plaintiffs' interest or as asserting a diminution in the value thereof.

C. Knew and intended that the conduct of such third parties as prospective lenders, contractors, purchasers, and lessees would be determined by their knowledge of the matter so published.

D. Knew that the rights of plaintiffs under the trust deed were valid and subsisting, that no ground existed for claiming default of the trust deed, and that said published claim was wholly false.

19. Said claim of defendant so published was in fact understood by such third parties in the manner so intended by defendant that it be understood.

20. As a further disparagement to plaintiffs' title, defendants, on December 29, 1978, caused to be recorded a Notice of Default and Election to Sell under Deed of Trust on the real property. In recording said instrument, defendants cast a cloud on and a slander on plaintiffs' title to the real property described herein; recording of said notice by defendant has rendered the real property unmarketable, all to the damage of said real estate and to plaintiffs in the approximate sum of $78,500.00.

21. As a further direct and proximate result of said disparagement, it has become necessary for plaintiffs to employ legal counsel to seek a judicial declaration of plaintiffs' rights under the trust deed, and to clear plaintiffs' said fee interest of the cloud created by said disparagement. The cost to plaintiffs of seeking such judicial declaration cannot presently be ascertained. Plaintiffs pray that, at such time as the extent of such costs can be ascertained, plaintiffs be permitted to amend this complaint to state the amount thereof.

22. The acts of said defendants, and each of them, as herein alleged, have been actuated by malice, and said defendants, and each of them, have been guilty of oppression and malice in their actions; this is a proper case for punitive damages in the sum of $25,000,000.00

THIRD CAUSE OF ACTION

23. Plaintiffs hereby reallege paragraphs 1 through 14, inclusive, of the first cause of action and incorporate each hereof by reference as though set forth in full.

24. That the within action filed by plaintiffs will not come before the above entitled court for trial on the merits until after the date upon which defendant may legally hold a sale of plaintiffs' real property.

25. That the sale thereof will cause plaintiffs grievous and irreparable injury and loss, and they will be irrevocably divested of all right, title and interest in and to the real property, as well as suffering the loss of a substantial cash investment made therein pursuant to the purchase thereof.

26. That said sale of real property prior to the trial in this action will cause plaintiffs grievous and irreparable loss without affording plaintiffs opportunity to argue their case upon its merits before the above entitled court. The sale of the real property prior to adjudication will in actual fact

render this action moot, leaving plaintiffs to absorb all costs therefrom without having obtained the benefit of a court hearing.

27. To prevent said injury and harm, plaintiffs seek to temporarily enjoin defendant from any further perpetration of acts relating to or constituting a sale of the subject real property.

WHEREFORE, plaintiffs pray judgment against defendants as follows:

1. For a judicial determination and declaration that the acceleration (due-on-sale) clause in the subject trust deed is not enforceable against plaintiffs without defendant Fidelity first demonstrating harm to its security interest.

2. For a permanent injunction against any foreclosure proceedings in reliance on said clause as alleged herein.

3. For a judicial determination and declaration that defendants have maliciously impunged [sic] plaintiffs' title to the subject real property and that no default under the subject trust deed in fact exists.

4. For general damages in the sum of $78,500.00.

5. For exemplary damages in the sum of $25,000,000.00.

6. For reasonable attorney's fees incurred herein.

7. For costs of suit incurred herein.

8. For such other relief as the Court deems just.

Dated: March 2, 1979

FRED CRANE, A Professional Corporation
By /s/ Timothy Newlove
Timothy Newlove
Attorney for Plaintiff

EXHIBIT A.

DEED OF TRUST

(With Assignment of Rents and Incorporating Recorded Provisions)

Book 10245, Page 490

(This is ☐ is not ☒ a Construction Trust Deed. Loan No. 58831 IT

THIS DEED OF TRUST made the 17th day of July, 1972, between CARTER WOOD AND IRENE R. WOOD, Husband and Wife, the Owner, herein called trustor, whose address is 7392 Natal Drive, Westminster, California and Gateway Mortgage Corporation, a Corporation, herein called Trustee, and FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, a United States Corporation, the Lender, herein called Beneficiary.

1. TRUSTOR, FOR THE PURPOSE OF SECURING:

(a) The payment according to its terms, of Trustor's Promissory Note of even date herewith in the principal sum of $29,200.00 together with interest thereon payable to Beneficiary, or order, and all extensions and renewals thereof;

(b) Performance of each agreement of Trustor incorporated by reference or herein contained;

(c) The payment of all sums of money with interest which may be paid out or advanced by, or may otherwise be due to Trustee or Beneficiary under any provision of this Deed of Trust;

(d) Payment of such further sums as the record owner of the subject property may hereafter borrow from beneficiary; its successors or assigns when said borrowing is evidenced by a promissory note or notes reciting that it or they are so secured;

(e) Performance of each agreement of Trustor contained in any building loan agreement, entered into between Trustor and Beneficiary, for the construction of improvements on the herein described property;

(f) Payment, with interest thereon, of any other present or future indebtedness or obligation of Trustor (or of any successor in interest of the Trustor to said property) to the Beneficiary, whether created directly or acquired by assignment, whether absolute or contingent, whether due or not, whether otherwise secured or not, or whether existing at the time of the execution of this Deed of Trust, or arising thereafter; and

(g) Performance and discharge of each and every obligation, covenant and agreement of Trustor herein contained and in any and all pledge agreements, supplemental agreements, assignments of lessor's interests in leases, or other instruments of security, or rental assignments, executed by Trustor as of even date herewith or at any time subsequent to the date hereof for the purpose of further securing any indebtedness hereby secured, or any part thereof, or any further advancements of further or additional loans of any sums hereafter made by Beneficiary or any successor of Beneficiary holding this note, to Trustor or any successor of Trustor owning the real property described herein during the continuance of these trusts and secured hereby, or for the purpose of supplementing or amending this Deed of Trust or any instrument secured hereby; HEREBY IRREVOCABLY GRANTS, TRANSFERS AND ASSIGNS TO TRUSTEE IN TRUST WITH POWER OF SALE, that certain real property in the County of Orange, State of California, described as:

Lot 38 of Tract No. 3165, in the City of Westminster, as shown on a map thereof recorded in Book 94, pages

4, 5, and 6, Miscellaneous Maps, records of said Orange County.

commonly known and designated as 7392 Natal Drive, Westminster, California.

TOGETHER WITH all interest which Trustor now has or may hereafter acquire in or to said property and in and to: All sums of money payable on the purchase price of said property secured by a lien thereon or payable under any agreement for the sale thereof; All easements and rights of way appurtenant thereto; All buildings and improvements now and hereafter located thereon; All adjacent lands within enclosures or occupied by buildings partly on the above described property; All water and water rights (whether or not appurtenant) and shares of stock pertaining to water and water rights; All personal property of every kind and nature whatsoever, other than consumable goods, now or hereafter located in or upon said real estate or any part thereof and used or usable in connection with any present or future operation of said property (hereinafter called "equipment") and now owned or hereafter acquired by Trustor, including, but without limiting the generality of the foregoing; All inlaid floor coverings, shrubs, trees, carpeting, drapes and drape rods, garbage disposals, dishwashers, water heaters, plants, machinery, apparatus, fittings, fixtures, heating, lighting, laundry, incinerating, power equipment, engines, pipes, pumps, tanks, motors, conduits, switchboards, plumbing, lifting, cleaning, fire prevention, fire extinguishing, refrigerating, ventilating, communications apparatus, air cooling and air conditioning apparatus, elevators, escalators, shades, awnings, screens, storm doors and windows, stoves, refrigerators, attached cabinets, partitions, ducts and compressors, and all of the right, title and interest of Trustor in and to any equipment which may be subject to any security agreement, conditional bill of sale or chattel

mortgage superior in lien to this Deed of Trust. It is understood and agreed that all said personal property and equipment is part and parcel of said real property and appropriated to the use of said property and whether affixed or annexed or not, shall for the purposes of this Deed of Trust be deemed conclusively to be real property and conveyed hereby, Trustor agrees to execute and deliver, from time to time, such further instruments as may be requested by Beneficiary to confirm the lien of this Deed of Trust on any such equipment.

2. TRUSTOR ABSOLUTELY AND IRREVOCABLY ASSIGNS to Beneficiary the rents, issues and profits of the subject property for the purposes and upon the terms and conditions hereinafter set forth.

3. Trustor agrees, by the execution and delivery hereof, that Trustor shall pay $15.00 or such greater amount authorized by law, for a written statement of obligation (C.C.C. 2943) regarding the obligation secured by this Deed of Trust.

4. TRUSTOR AGREES:

(a) Taxes, Liens and Fees: To pay, when due, at least 10 days before delinquency, all taxes, bonds and assessments including assessments on appurtenant water stock, with interest, fees, and penalties, and to pay, when due, all other charges, liens and encumbrances, with interest, fees, and penalties, which now are or shall hereafter be or appear to be a lien upon said property or any part thereof, and to pay all costs, fees, and expenses of this trust, and in default thereof. Trustee or Beneficiary, without obligation so to do and without demand or notice upon Trustor, may pay the same. Trustee or Beneficiary shall be the sole judge of the legality thereof and of the amounts necessary to be paid. (1) In the event of the passage after the date of this Deed

of Trust of any law of the State of California, deducting from the value of real property for the purposes of taxation any lien thereon, or changing in any way the laws of the taxation of deeds of trust or debts secured by deed of trust for state or local purposes, or the manner of the collection of any such taxes, so as to affect this Deed of Trust, the holder of this Deed of Trust and of the debt which it secures shall have the right to declare the principal sum and the interest due on a date to be specified by not less than thirty (30) days' written notice to be given to Trustor by Beneficiary; provided, however, that such election shall be ineffective if Trustor is permitted by law to pay the whole of such tax in addition to all other payments required hereunder and, if prior to such specified date, does pay such tax and agrees to pay any such tax when hereafter levied or assessed against the premises, and such agreement shall constitute a modification of this Deed of Trust. (2) To include as an addition to each monthly payment provided for in the note secured by this Deed of Trust, should Beneficiary so elect, a sum necessary to establish an adequate reserve for use in payment of annual taxes, assessments and insurance premiums. This reserve shall be non-interest bearing and until disbursed, or applied as provided hereinafter, at option of Beneficiary, constitutes security for the loan, and may be commingled with other funds of the Beneficiary. Prior to disbursement or application thereof, said funds may be utilized by Beneficiary who is entitled to all earnings thereon, if any.

(b) Insurance: To keep said property insured against loss or damage by fire and other risk which, in the opinion of Beneficiary, should be insured against, under policies of insurance with loss payable to Beneficiary (by means of a loss payable clause of endorsement in a form satisfactory to Beneficiary and without contribution, if obtainable) in form, amount and companies acceptable to Beneficiary.

Said policies shall be delivered to, and remain in possession of Beneficiary as further security for the faithful performance of these obligations, which delivery shall constitute an assignment by Trustor to Beneficiary of all rights thereunder, including return of premium; to delivery to Beneficiary a policy or policies renewing or extending any expiring insurance with a receipt showing premiums paid at least thirty (30) days before expiration and in default thereof, Beneficiary may procure such insurance as it may elect and may make payment of premiums thereon which payment is repayable on demand and is secured hereby, or charge Trustor a reasonable service fee, or an amount authorized by law for the costs of processing any late insurance policy. In no event and whether or not default hereunder has occurred shall Beneficiary, by the fact of approving, accepting or obtaining such insurance, incur any liability for the amount of such insurance, the form or legal sufficiency of insurance contracts, solvency of insurers, or payment of losses by insurers, and Trustor hereby assumes full responsibility therefor and liability, if any, thereunder. In case of any loss the amount collected under any policy of insurance on said property may, at the option of the Beneficiary, be applied by Beneficiary upon any indebtedness and/or obligation secured hereby and in such order as Beneficiary may determine; or said amount or any portion thereof may, at the option of the Beneficiary, either be used in replacing or restoring the improvements partially or totally destroyed to a condition satisfactory to said Beneficiary, or be released to the Trustor, in either of which events neither the Trustee nor the Beneficiary shall be obligated to see the proper application thereof; nor shall the amount so released or used be deemed a payment on any indebtedness secured hereby. Such application, use, and/or release shall not cure or waive any default or notice of default hereunder or invalidate any

act done pursuant to such notice; any unexpired insurance and all returnable insurance premiums shall inure to the benefit of, and pass to, the purchaser of the property covered thereby at any Trustee's sale held hereunder. For each cancellation or substitution of a policy of insurance by the Trustor, the Beneficiary reserves the right to make a charge not to exceed $10.00. Said charge, secured hereby, shall be immediately due and payable, but, at Beneficiary's option, it may be added to the loan.

(c) Maintenance: To keep said property in good condition and repair; to complete or restore promptly and in good and workmanlike manner any building which may be constructed, damaged or destroyed thereon and to pay, when due, all claims for labor performed and materials furnished therefore and for any alterations thereof; to comply with the provisions of all insurance policies covering, and with all laws, ordinances and regulations affecting said property; not to remove, demolish or materially alter any building at any time thereon unless the written consent of Beneficiary is first had and obtained; not to allow the said property to become unoccupied or vacant for a period of three (3) or more successive months at any one time; not to commit or permit any waste thereof or any act upon said property in violation of law or of deed restrictions; to cultivate, irrigate, fertilize, fumigate, prune and do all other acts, in a timely and proper manner, which from the character or use of said property may be reasonably necessary to protect and preserve said security, the specific enumerations herein not excluding the general.

(d) Construction of Improvements: If the loan secured hereby or any part thereof is being obtained for the purpose of construction of improvements on said property, Trustor also agrees, anything in this Deed of Trust to the contrary notwithstanding: (1) to complete same in accordance with

plans and specifications satisfactory to Beneficiary; (2) to allow Beneficiary to inspect said property at all times during construction; (3) to replace any work or materials unsatisfactory to Beneficiary, within fifteen (15) calendar days after written notice from Beneficiary of such fact, which notice may be given to the Trustor by registered mail, sent to this last known address, or by personal service of the same; (4) that work shall not cease on the construction of such improvements for any reason whatsoever for a period of fifteen (15) calendar days. Trustor agrees to commence said construction within (30) days after the recordation of this instrument, and to diligently and efficiently complete said construction without delay. In the event the Trustor or any contractor engaged by the Trustor shall cease work upon said construction prior to its completion, then the Beneficiary herein shall have the immediate right, with or without notice to the Trustor, to go upon the premises and to complete or have completed the construction, and the advances, if any, made by the Beneficiary for the completion of said construction will be secured by this Deed of Trust and shall be due and payable by the Trustor upon demand by the Beneficiary; to maintain, at all times during construction, a display sign in a form acceptable to Beneficiary stating Beneficiary is the construction lender.

(e) Defending Trust: To defend this Trust in any action or proceeding purporting to affect said property, and to file and prosecute all necessary claims and actions to prevent or recover for damage to, taking of, or destruction of said property; and either Trustee or Beneficiary, or both, at any time during the continuation of this Trust, is hereby authorized, without obligation so to do, to commence, appear in or defend any such action or proceeding, whether brought by or against Trustor, Beneficiary or Trustee, or with or without suit, to exercise or enforce any other right, remedy,

or power available or conferred hereunder, whether or not judgment be entered in any action or proceeding; and Trustee or Beneficiary may commence, appear or intervene in any action or proceeding, and retain counsel therein, and take such action therein; as either may be advised, and may settle, compromise or pay the same or any other claims and, in that behalf and for any of said purposes, may expend and advance such sums of money as either may deem reasonable. Trustor agrees to pay all attorney's fees and costs incurred by Beneficiary should Beneficiary be made a party to any litigation in which Trustor is also a party, the repayment of which, together with interest thereon at the rate provided in said promissory note, is secured hereby.

(f) Reimbursement: Beneficiary or Trustee, without obligation so to do or notice to or demand upon Trustor and without liability for anything done or omitted while performing the same and without releasing Trustor from any obligation hereunder, may perform any act herein agreed to be performed by Trustor; and Trustor will repay to Trustee or Beneficiary, upon demand, all amounts which they or either of them may incur in defending this Trust or in exercising any right, privilege or remedy hereunder, including, but not limited to, cost of surveys, evidence of title, court costs and reasonable attorneys' fees, together with interest thereon at the rate of ten percent (10%) per annum, the repayment of which is secured hereby.

(g)(1) Condemnation: All settlement, awards or damages in connection with any condemnation for public use of or any injury to said property, or any part thereof, from same, are hereby assigned and shall be paid to Beneficiary, whch may apply said moneys to any indebtedness secured hereby or release the same, or any part thereof, as it may elect. (2) Injury to Property: All causes of action, whether accrued before or after the date of this Deed of Trust, of

all types for damage or injury to said property or any part thereof, or in connection with this transaction financed by funds loaned to Trustor by Beneficiary or in connection with or affecting said property or any part thereof, including causes of action arising in tort or contract and causes of action for fraud or concealment of a material fact, are, at Beneficiary's option, assigned to Beneficiary and the proceeds shall be paid to Beneficiary, who may, after deducting therefrom all its expenses, including reasonable attorneys' fees, apply or release any moneys so received by it in such manner and with the same effect as above provided for the disposition of proceeds of fire and other insurance. Beneficiary may at its option appear in and prosecute in its own name any action or proceeding to enforce any such cause of action and may make any compromise or settlement thereof. Trustor agrees to execute such further assignments of any compensation award, damage and causes of action as Beneficiary shall request.

(h) Inspection: Either Beneficiary or trustee, or both, at any time during the continuation of this Trust may enter and inspect said encumbered property.

(i) Reconveyance: If Trustor shall pay or cause to be paid in full said promissory note and all sums herein agreed to be paid by Trustor or secured hereby and the interest thereon, and also the reasonable expense of this Trust, then Trustee, upon delivery to it of this Deed of Trust, said promissory note marked fully paid, and satisfactory evidence of the payment in full of all other indebtedness hereby secured shall, upon the written request of Beneficiary, reconvey, without warranty regarding title, possession or encumbrance, all of the estate in said property granted to Trustee under the terms hereof and not theretofore reconveyed. The grantee in such reconveyance may be described and designated as "the person or persons legally entitled

thereto" or "the present holders of the equitable title of the real property described in said Deed of Trust." All reconveyances in whole or in part shall be at the sole cost of the grantee. The recitals in such reconveyance of any matters or facts shall be conclusive proof of the truthfulness thereof.

(j) Late Charge: To Pay "late charge" provided for in any note secured hereby.

(k) Default: Default shall occur if: (1) payment of performance of any note, indebtedness, liability or obligation secured hereby or of any interest thereon be not made at the time or in the manner agreed; or (2) Trustor fails to perform any of its obligations hereunder; or (3) [should Trustor or any successor in interest to Trustor in such property sell, sell under contract of sale, lease with option to purchase, convey, transfer, encumber, or alienate said property, or any part thereof, of any interest therein], . . . or drill or extract or enter into a lease for the drilling or extraction of oil, gas or other hydrocarbon substances or any mineral of any kind or character therefrom, or from any part thereof, [or be divested of his title or any interest therein in any manner or way, whether voluntary or involuntary, Beneficiary shall have the right, at its option, to declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in any note or written agreement evidencing the same, immediately due and payable] and no waiver of this right shall be effective unless in writing and signed by Beneficiary; waiver of this right granted to Beneficiary as to one transaction or occurence shall not be deemed to be a waiver of said right as to any subsequent transaction or occurrence; if Beneficiary exercises said option and Trustor fails to pay all such sums, it shall constitute a default hereunder; or (4) if this Deed of Trust or any note secured hereby provides any charge for prepayment of any indebtedness secured hereby and Trustor fails to pay same,

Trustor agrees to pay said prepayment charge if any of said indebtedness shall be paid prior to the due date thereof stated in said note or this Deed, even if and notwithstanding Trustor shall have defaulted in payment thereof, or in performance of any agreement hereunder, and Beneficiary, by reason thereof, shall have declared all sums secured hereby immediately due and payable; or (5) said property be subject to abatement proceedings; or (6) any financial information given by Trustor to Beneficiary be not true in any material respect or any essential financial information be withheld by Trustor from Beneficiary; or (7) said property, or any part thereof, be attached or become subject to any other legal process and be not released therefrom within ninety (90) days; or (8) Trustor(s) (or any one of them) die, be declared incompetent, become insolvent, make an assignment for the benefit of creditors, be the subject of any bankruptcy proceeding, reorganization, arrangement, insolvency, receivership, liquidation or dissolution proceedings; or (9) (In the event that the indebtedness secured hereby was incurred for the purpose of enabling Trustor to acquire said property for his dwelling and Trustor shall fail at any time to occupy such property as his dwelling without the prior written consent of the Beneficiary being first obtained), the Trustee, upon presentation to it of an affidavit signed by Beneficiary setting forth facts showing a default by Trustor under this paragraph is authorized to accept as true and conclusive all facts and statements therein, and to act thereon hereunder.

(l) Remedies: Upon the happening of any such default, Beneficiary or Trustee, or both, may, without the necessity of any notice to or demand upon Trustor or any other party liable for the said indebtedness or having an interest in said property, may do any or all of the following: (1) declare all indebtedness secured hereby immediately due and pay-

able; (2) take possession of and operate said property and any personal property thereon used in the operation of said property and any business conducted thereon without liability or obligation on its part, and do all such acts affecting said property as Beneficiary may deem necessary to conserve the value thereof; (3) to the extent permitted by law, bring an action to enforce the payment of any note or indebtedness secured hereby without the necessity of exercising any remedy hereunder or the prior sale of said property and without thereby waiving any other right or remedy; (4) perform any of the foregoing acts with or without bringing any action or proceeding, or through a receiver appointed by a court, and in any case without necessity of having given or recorded any notice of default or election to sell and without regard to the adequancy [sic] of security; (5) bring an action in any court of competent jurisdiction to foreclose this Deed of Trust; (6) elect to sell said property or any part thereof; (7) apply any funds in possession of Beneficiary including, but not limited to, funds under the provisions of paragraphs 4(a) and 3(b), at option of Beneficiary, to the payment of principal and/or interest upon the obligation secured hereby in lieu of being applied to any of the purposes for which the fund was established.

(m) Sale: In case of election to sell, Trustee or Beneficiary shall record in each office of the Recorder of the County wherein said property or any part thereof is situated a notice of default and of the election of Beneficiary to sell said property. Such notice of default shall contain such further recitals as may be required by law, and after notice of recordation has been given to all parties entitled thereto, and the period required by law shall have elapsed following the recordation of said notice of default, Trustee, without demand on Trustor, after giving the notices required by law, shall sell said property, or such part thereof as in its sole

discretion it shall find necessary, in the manner required by law. Trustee may postpone said sale either by publishing, prior to the date thereof, a notice of such postponement in the same newspaper in which the original notice of sale was published, or by public announcement at the time and place fixed in the original notice of sale, and may thereafter postpone said sale from time to time by like publication or announcement, and at the time and place so advertised or to which such sale may have been postponed. Trustee may sell the property as a whole or in parcels, and if in parcels in such order, as Trustee may determine at public auction to the highest bidder for cash in lawful money of the United States. Said sale may take place in any County in which the property or any portion thereof is located. Trustee in conducting said sale may act through agents, attorneys or auctioneers. Any person, including Trustor or Trustee or Beneficiary, may purchase at such sale.

(n) Proceeds of Sale: Upon such sale, Trustee shall, after receipt of the amount paid, deliver to the purchaser its Deed conveying said property without warranty as to title, possession or encumbrances and shall apply the proceeds of the sale in the following order to the payment of: (1) expenses of sale; (2) costs, fees, charges and expenses of Trustee and of this Trust, including attorneys' fees in a reasonable amount; (3) costs of evidence of title and Trustee's fee in connection with such sale; (4) all sums expended under any of the terms hereof by Trustee or Beneficiary not then repaid, with accrued interest at the rate of ten percent (10%) per annum; (5) accrued interest on said note or notes; (6) unpaid principal of said note or notes; and (7) all other obligations of Trustor to Beneficiary secured hereby; and any remainder shall be paid to the person or persons legally entitled thereto upon proof of such right. The recitals in such Deed of any matters, proceedings and

facts shall be conclusive proof of the truthfulness and regularity thereof. Trustor agrees to surrender possession of said property to the purchase immediately and without demand.

(o) Consent, etc.: Without affecting the liability of any person, including Trustor, for the payment of any indebtedness secured hereby or the lien of this Deed of Trust for the full amount of the indebtedness then remaining unpaid (other than any person or property specifically released by Beneficiary), Beneficiary or Trustee, if so requested by Beneficiary, may from time to time without liability of Beneficiary or Trustee therefor and without notice do any one or more of the following: (1) release any indebtedness; (2) extend the time or otherwise alter the terms of payment of any such indebtedness; (3) accept additional security; (4) substitute or release any property securing such indebtedness; (5) reconvey any part of said property; (6) consent to the making of any map or plat thereof; (7) join in granting any easement thereon; or (8) join in any extension agreement or any agreement subordinating the lien or charge hereof.

(p) Assumption: If an assumption of the loan secured by this Deed of Trust is approved by Beneficiary, it shall not release Trustor from any obligations hereunder.

(q) Payment for Services: Beneficiary may charge Trustor a reasonable fee for any other service rendered Trustor, or on his behalf, connected with this Deed, or the loan secured hereby, including, without limiting the generality of the foregoing, the delivery to an escrow holder of a request for full or partial reconveyance of this Deed; transmitting to an escrow holder moneys secured hereby; changing its records pertaining to this Deed and the loan secured hereby to show a new owner of said property; replacing an existing policy of fire insurance or other casualty insurance, held by Beneficiary hereunder, with another such policy.

Any such charge shall be secured hereby and Trustor agrees to pay the same, together with interest from the date of such charge at the rate of ten percent (10%) per annum immediately and without demand.

5. GENERAL PROVISIONS: IT IS MUTUALLY AGREED THAT:

(a) Beneficiary may, at any time by instrument in writing acknowledge by Beneficiary and record in the Office of the Recorder of the County or counties where said property or any part thereof is situated, appoint a new Trustee in place of the Trustee named herein, who shall thereupon have all of the estate, powers and duties of the predecessor Trustee.

(b) Trustee may at any time, and without notice, upon written request of Beneficiary reconvey any portion of said property to the persons legally entitled thereto without warranty as to title, possession or encumbrance, without affecting the personal liability of any person for the payment of said note or any indebtedness secured hereby or the lien of the Deed of Trust on the remainder of said property.

(c) Acceptance by Beneficiary of any sum on account of any indebtedness secured hereby, after the date when such sum is due or after recording a notice of default and election to sell, shall not constitute a waiver of the right either to require prompt payment when due of all sums secured hereunder or to declare a default for failure to pay or a waiver of the right to proceed with the sale of said property under such notice for any unpaid balance of said indebtedness.

(d) No remedy herein provided shall be exclusive of any other remedy herein or now or hereafter existing by law, but shall be cumulative. Every power or remedy hereby given to Trustee or to Beneficiary or to which either of them

may be otherwise entitled, may be exercised from time to time and as often as may be deemed expedient by them, and either of them may pursue inconsistent remedies. If Beneficiary holds any additional security for any obligation secured hereby, it may enforce the sale thereof at its option, either before, contemporaneously with, or after the sale is made hereunder, and on any default of Trustor, Beneficiary may, at its option, offset against any indebtedness owing by it to Trustor, the whole or any part of the indebtedness secured hereby, and the Beneficiary is hereby authorized and empowered at its option, without any obligation so to do, and without affecting the obligations hereof, to apply toward the payment of any indebtedness of the Trustor to the Beneficiary, any and all sums or [sic] money which the Beneficiary may have in its possession or under its control, including without limiting the generality of the foregoing, the indebtedness evidenced by an investment certificate or any escrow or trust funds.

(e) Trustee or Beneficiary, or both, may at any time after the expiration of five (5) years after Trustee ceases to act under, or has conveyed or otherwise ceased to hold all property subject to this Deed of Trust, destroy without liability for so doing all documents, papers and correspondence (including this Deed of Trust) relating thereto.

(f) Despite any contrary provision herein or in the promissory note of Trustor, Beneficiary shall have the absolute right to direct the manner in which payments or proceeds shall be applied upon or allocated among the various items composing Trustor's indebtedness secured hereby.

(g) Whenever the context so requires, the masculine includes the feminine and neuter and the singular includes the plural. The term "Beneficiary" includes not only the original Beneficiary hereunder but also any future owner

and holder including pledgees of the promissory note and indebtedness secured hereby.

(h) Time is of the essence of all Trustor's obligations hereunder; and to the extent permitted by law, Trustor waives all present or future statutes of limitation with respect to debt, demand or obligations secured hereunder in any action or proceeding for the purpose of enforcing this Trust or any rights or remedies thereunder.

(i) Recourse may be had against the separate property of any Trustor who is a married woman for all indebtedness or liability to Beneficiary hereunder.

(j) This Deed applies to, inures to the benefit of, and binds all parties hereto, their heirs, legatees, devisees, administrators, executors, successors, and assigns.

(k) Trustee accepts this Trust when this Deed, duly executed and acknowledged, is made a public record as provided by law. Trustee is not obligated to notify any party hereto of pending sale under any other Deed of Trust or of any action or proceeding in which Trustor, Beneficiary, or Trustee shall be a party unless brought by Trustee.

(l) If two or more persons be designated as Trustee herein, any, or all, powers granted herein to Trustee may be exercised by any of such persons, if the other person or persons is unable, for any reason, to act, and any recital of such inability in any instrument executed by any of such persons shall be conclusive against Trustor, his heirs, and assigns.

(m) This Deed of Trust cannot be changed except by agreement in writing signed by Trustor and Beneficiary.

(n) Beneficiary confers upn Trustor the authority, during the continuance of these trusts, to collect and retain the rents, issues and profits of the subject property as they become due and payable and to collect all sums of money

payable on the purchase of said property secured by a lien thereon or payable under any agreement for sale thereof subject, however, to the right of Beneficiary to revoke said authority at any time in its sole discretion and without notice to Trustor, and without regard to the adequacy of any security for the indebtedness hereby secured. Beneficiary may revoke said authority and, either in person, by agent, or by a receiver appointed by a court, collect and retain the said rents, issued and profits, and sums of money (including those past due and unpaid) whether or not Trustor is in default hereunder or under any of the obligations secured hereby, and with or without, at Beneficiary's option, taking possession of all or any part of the subject property. Any rents, issues and profits or other sums collected may be applied by Beneficiary, less costs and expenses of operating and collection, including reasonable attorneys' fees, in its sole discretion, against the indebtedness secured hereby, any obligations of Trustor arising hereunder or any other obligations of Trustor to Beneficiary, whether existing on the date hereof or hereafter arising. Collection of any rents, issues and profits and other sums of money by Beneficiary shall not cure or waive any default or notice of default hereunder or invalidate any acts done pursuant to such notice.

(o) Beneficiary or Trustee, or both, are authorized to enter upon the herein described property to protect the security hereof. Beneficiary or Trustee, or both, are authorized to commence, appear in and defend any action or proceeding purporting to affect the security hereof or the rights, powers, duties or liabilities of Beneficiary or Trustee, or both, or the payment of any funds in possession of either the Beneficiary or Trustee arising out of or in connection with this Deed of Trust or loan; to pay, purchase, contest or compromise any encumbrance, charge or lien which in the judg-

ment of either appears to be prior or superior hereto; and, in exercising any such powers, pay necessary expenses, employ counsel and pay his reasonable fees.

(p) Trustor will pay immediately and upon demand all sums, costs, fees and expenses (including, but not limited to, reasonable expenses for services of attorneys, accountants, real estate brokers and other persons and for contractors for labor and materials) incurred or paid by Beneficiary or Trustee to defend this trust, protect the property secured hereunder or in the exercise of any right, power or remedy for which provision is made hereunder or by law, with interest thereon at ten percent (10%) per annum from the date of expenditure thereof by Beneficiary or Trustee until paid, and the same shall be secured hereby; and to the extent that any funds in possession of either the Beneficiary or Trustee are sufficient, the Beneficiary or Trustee shall have the right, but shall not be obligated to pay said sums, costs, fees and expenses out of said funds in lieu of the funds being applied as otherwise provided herein.

(q) If the security under this Deed of Trust is a condominium or a community apartment or planned development project, Trustor agrees to perform each and every obligation of the owner of such condominium or interest in such project under the declaration of covenants, conditions and restrictions pertaining to such condominium or project. Upon the request of Beneficiary, Trustor agrees to enforce against other owners in such condominium or project each and every obligation to be performed by them, if the same have not been performed or valid legal steps taken to enforce such performance within ninety (90) days after such request is made.

(r) If the security for this Deed of Trust is a leasehold estate, Trustor agrees not to amend, change, terminate or modify his leasehold interest or any subleases or rental

agreements thereunder, or agree to do so, without the written consent of Beneficiary being first obtained. In the event of a violation of this provision, Beneficiary shall have the right, at its option, to declare all sums secured hereby forthwith due and payable. Consent to one such modification shall not be deemed to be a waiver of the right to require such consent to future or sucessive amendments, changes or modifications. Waiver of the right to require such consent in one instance shall not be deemed to be a waiver of the right to require such consent in the event of amendments, changes or modifications occurring after the waiver. Trustor agrees to pay, when due, all rental and other payments including, but not limited to, taxes and assessments required under said leasehold, and otherwise to carry out all of the obligations and agreements to be performed by the lessee under the terms of said leasehold. The failure of Trustor to make any rental or other payment when due, or otherwise to perform all of the obligations of the lessee under the terms of said leasehold or this Deed of Trust, shall constitute a default under the terms of this Deed of Trust. A default by Trustor, voluntary or involuntary, curable or not, under the terms of said leasehold shall likewise be deemed to constitute a default under the terms of this Deed of Trust. All sums expended by Beneficiary in curing any default by Trustor under the terms of said leasehold shall be secured hereby, and Trustor agrees to pay to Beneficiary, immediately and without demand, all sums so expended by Beneficiary, with interest from date of expenditure at the rate of ten percent (10%) per annum.

(s) That, should the Trustor or any successor in interest to Trustor in such property drill or extract or enter into a lease for the drilling for or extraction of oil, gas or other hydrocarbon substances or any mineral of any kind or character, Beneficiary shall have the right, at its option, to

declare any indebtedness or obligations secured hereby irrespective of the maturity date specified in any note evidencing the same, immediately due and payable, and no waiver of this right shall be effective unless in writing. Consent to one such transaction shall not be deemed to be a waiver of the right to require such consent to future or successive transactions.

(t) To supply the Beneficiary, within ten (10) days after written request, an accurate written report covering the project named in the Beneficiary's request listing the name of each tenant, the amount of monthly rent paid by each tenant, and the current status of each tenant's lease payments. Upon written demand by the Beneficiary, made in any year when this Deed of Trust shall be in existence, Trustor agrees to make in writing and to deliver at the place then designated for the making of payments on the indebtedness secured by this Deed of Trust, within fifteen (15) days from the date of said demand, a sworn itemized statement to Beneficiary of all income and expense in connection with the operation of the property which is secured by this Deed of Trust. Trustor agrees that said statement shall cover the operations for the year preceding the date of said demand. Failure to deliver any such statements to Beneficiary at the time and place required shall constitute a default hereunder and shall entitle Beneficiary to enforce this Deed of Trust in the same manner as for any other default hereunder.

6. Trustor requests that a copy of any notice of default and of any notice of sale be mailed to each Trustor at the following address:

Signature of Trustor(s)	Address (Full address, street number, city, and state— must be given)
/s/ Carter Wood	
Carter Wood	
/s/ Irene R. Wood	7392 Natal Drive
Irene R. Wood	Westminster, California

State of California County of — ss. (ACKNOWLEDGEMENT BY INDIVIDUAL),

TO 447 C — (Individual).

State of California County of Los Angeles — ss.

On July 21, 1972 before me, the undersigned, a Notary Public in and for said State, personally appeared Carter Wood and Irene R. Wood, known to me to be the persons whose names are subscribed to the within instrument and acknowledged that they executed the same.

WITNESS my hand and official seal.

Signature /s/ Doris Dahl Graves
Doris Dahl Graves

EXHIBIT B.

GRANT DEED

AP # 096-464-04

Book 1291, Page 909

THE UNDERSIGNED GRANTOR(S) DECLARE(S)

DOCUMENTARY TRANSFER TAX is $57.20

☐ computed on full value of property conveyed, or

☒ computed on full value less value of liens or encumbrances remaining at time of sale, and

FOR A VALUABLE CONSIDERATION, receipt of which is hereby acknowledged, Carter Wood and Irene R. Wood hereby GRANT(S) to John D. Whitcombe, a single man, the following described real property in the city of Westminster, County of Orange, State of California:

Lot 38 of Tract No. 3165 as per map recorded in book 94 page 4-6 of Miscellaneous maps in the office of the County Recorder of Orange County, State of California

Dated Sept. 25, 1978

/s/ Carter Wood
Carter Wood
/s/ Irene R. Wood
Irene R. Wood

State of California, County of Orange — ss. —

On September 25, 1978 before me, the undersigned, a Notary Public in and for said State, personally appeared

Carter Wood
Irene R. Wood

known to me to be the person(s) whose name(s) is(are) subscribed to the within in-

strument and acknowledged that they executed the same. Witness my hand and official seal
Signature /s/ [Illegible]

EXHIBIT C.

Notice of Default and Election to
Sell Under Deed of Trust

NOTICE IS HEREBY GIVEN: That GATEWAY MORTGAGE CORPORATION a California corporation, is Trustee, succcessor Trustee or substituted Trustee, under a Deed of Trust dated July 17, 1972, executed by Carter Wood and Irene R. Wood, Husband and Wife as Trustor to secure certain obligations including one note(s) in the amount of $29,200.00 in favor of Fidelity Federal Savings and Loan Association, a corporation, Beneficiary, recorded as Instrument No. 26544 on July 28, 1972, in Book 10245, Page 490 of Official Records in the office of the County Recorder of Orange County, California.

> Lot 38 of Tract 3165, in the City of Westminster, as shown on map thereof recorded in Book 94, Pages 4, 5, and 6, Miscellaneous Maps, records of said Orange County.

That the beneficial interest under such Deed and the obligations secured thereby have not been transferred or assigned;

that a breach of, and default in, the obligations secured by said Deed of Trust have occurred in that payment has not been made of:

See Exhibit "A"

That by reason thereof the undersigned, the present Beneficiary under said Deed of Trust, has executed and delivered to said Trustee a written Declaration of Default and demand for sale, and has surrendered to said Trustee such Deed and all documents evidencing obligations secured thereby, and has declared and does hereby declare all sums secured thereby immediately due and has elected, and does hereby

elect, to cause the trust property to be sold to satisfy the obligations secured thereby.

Dated: December 20, 1978

Fidelity Federal Savings and Loan Association, a corporation formerly known as Fidelity Federal Savings and Loan Association of Glendale, a corporation.

(Seal)

By /s/ Catherine Derieg
Catherine Derieg, Vice President

By /s/ Barbara M. Breeden
Barbara M. Breeden, Assistant Secretary

NOTICE: You may have the right to cure the default described herein and reinstate the mortgage or deed of trust. Section 2924c of the Civil Code permits certain defaults to be cured upon the payment of the amounts required by that section without requiring payment of that portion of principal and interest which would not be due had no default occurred. Where reinstatement is possible, if the default is not cured within three months following the recording of this notice, the right of reinstatement will terminate and the property may be sold.

To determine if reinstatement is possible and the amount, if any, necessary to cure the default, contact the beneficiary or mortgagee or their successors in interest, whose name and address as of the date of this notice is —

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION
600 NORTH BRAND BLVD., GLENDALE, CALIF. 91203

EXHIBIT "A"

That a breach of, and default in, the obligations secured by said Deed of Trust have occurred in that a violation of the Acceleration Clause as contained in the Deed of Trust occurred in that "should Trustor or any successor in interest to Trustor in such property sell, sell under contract of sale, lease with option to purchase, convey, transfer, encumber, or alienate said property or any part thereof, or any interest therein . . . . or be divested of his title or any interest therein in any manner or way, whether voluntary or involuntary, Beneficiary shall have the right, at its option, to declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in any note or written agreement evidencing the same, immediately due and payable" i.e., the Trustor sold, conveyed, transferred, or disposed of said property without the written consent of the Beneficiary being first and obtained, and therefore, the Beneficiary has declared all sums secured thereby forthwith due and payable.

All subsequent installments of principal and interest installments aforementioned, if any, along with late charges, foreclosure costs, legal fees, or advances that may become due.

EXHIBIT D.

[Letterhead]

November 29, 1978

Fidelity Federal Savings
P O Box 1631
Glendale, CA 91209

Re: Loan Number, 158831
Original Trustor: WOOD, Carter/Irene
New Owner: WHITCOMBE, John
Mailing Address: 7392 Natal Dr
Westminster, CA 92683

Gentlemen:

You are kindly requested to reflect on your mailing records under this loan the new owner of the security therefor and their mailing address as captioned.

Enclosed are the following checked items:

_____ 1) Installment payment of $_____.

__xx__ 2) Grant deed to the new ownership.

_____ 3) Policy of title insurance showing new ownership.

__xx__ 4) Reservation of Rights Agreement executed by the new owner, in duplicate.

_____ 5) Other:

_____ 6) Other:

Please sign and return to us one copy of the Reservation of Rights Agreement referred to in Item 4, if applicable. Should you have any concern for the possible impairment of your

securing interest resulting from this transfer, please direct your inquiries to me.

Very truly yours,

Fred Crane

FC:ly
Enclosures

John D. Whitcombe
7392 Natal
Westminster, CA 92683

FIDELITY FEDERAL
SAVINGS AND LOAN ASSOCIATION

818

Account No.

FIDELITY FEDERAL SAVINGS
AND LOAN ASSOCIATION

Incorporated Under the Laws of the United States of America

SAVINGS ACCOUNT

This certifies that _____

_____

_____

holds a savings deposit in Fidelity Federal Savings and Loan Association, subject to its charter and by-laws, the Rules and Regulations for the Federal Savings and Loan System, and to the laws of the United States of America.

WITNESS the authorized signature of officer this

_____ day of _____, 19 ____.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION

Spencer Scott
PRESIDENT

Federal Savings and Loan Insurance Corporation
Certificate of Insurance No. 1880

This is to Certify that

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION

has been granted insurance as is provided in Title IV of the National Housing Act, as amended, provided the insurance of accounts shall not become effective until such institution shall have complied with all the conditions precedent to the commencement of business as such insured institution specified in the certificate of approval issued by the Corporation.

Executed at Washington, District of Columbia, this 16th day of October, 1937.

Federal Savings and Loan Insurance Corporation

Attest: _____ By _____

Originally Issued October 16, 1937

1

No. 00-03-6003546

	DATE	WITHDRAWALS	INTEREST	DEPOSITS	BALANCE
3	FEB 5-78			210.00	210.00 801B
4	FEB1379 CDP			205.00	415.00 0802A
5					
6					
7					
8					
9					
10					
11					
12					
13					
14					
15					
16					
17					
18					
19					
20					
21					
22					
23					
24					

820

1

ATTORNEY VERIFICATION

I, Timothy Newlove, declare as follows:

1. I am an attorney at law admitted to practice before all courts of the State of California, and have my office in Riverside County, California.

2. I am the attorney for plaintiffs herein, and plaintiffs are unable to make the verification because they are absent from said county, and for that reason affiant makes this verification on plaintiffs' behalf.

3. I have read the foregoing Complaint and am informed and believe the matters therein to be true and on that ground allege that the matters therein are true.

4. Executed this 2nd day of March, 1979 at Riverside, California.

I declare under penalty of perjury that the foregoing is true and correct.

Timothy Newlove
TIMOTHY NEWLOVE

Answer and Affirmative Defenses.

Superior Court of the State of California for the County of Orange.

John D. Whitcombe, Plaintiff, v. Fidelity Federal Savings & Loan Association, a federally chartered association, Gateway Mortgage Corporation, a California corporation, and Does 1 through 10, inclusive, Defendants. No. 30-85-27.

Defendants Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation (herein collectively "Fidelity Federal") answer plaintiff's complaint for themselves alone as follows:

FIRST CAUSE OF ACTION

1. Fidelity Federal admits the allegations contained in paragraph 1 of the plaintiff's complaint.

2. Fidelity Federal admits the allegations contained in paragraph 2 of the plaintiff's complaint.

3. Fidelity Federal is without sufficient knowledge or information to form a belief as to the truth of the allegations contained in paragraph 3 of the plaintiff's complaint and therefore, on that basis, denies each and every allegation contained therein.

4. Fidelity Federal admits the allegations contained in paragraph 4 of the plaintiff's complaint.

5. Fidelity Federal admits the allegations contained in paragraph 5 of the plaintiff's complaint.

6. Fidelity Federal admits the allegations contained in paragraph 6 of the plaintiff's complaint.

7. Fidelity Federal admits the allegations contained in paragraph 7 of the plaintiff's complaint.

8. Fidelity Federal admits the allegations contained in paragraph 8 of the plaintiff's complaint.

9. Fidelity Federal admits the allegations contained in paragraph 9 of the plaintiff's complaint.

10. Fidelity Federal is without sufficient knowledge or information to form a belief as to the truth of the allegations contained in paragraph 10 of the plaintiff's complaint and therefore, on that basis, denies each and every allegation contained therein.

11. Fidelity Federal denies each and every allegation contained in paragraph 11 of the plaintiff's complaint.

12. Fidelity Federal admits the allegations contained in paragraph 12 of the plaintiff's complaint.

13. Fidelity Federal is without sufficient knowledge or information to form a belief as to the truth of the allegations contained in paragraph 13 of the plaintiff's complaint and therefore, on that basis, denies each and every allegation contained therein.

14. Fidelity Federal denies each and every allegation contained in paragraph 14 of the plaintiff's complaint.

15. Fidelity Federal denies each and every allegation contained in paragraph 15 of the plaintif's complaint.

SECOND CAUSE OF ACTION

16. Fidelity Federal refers to and realleges its answers to paragraphs 1 through 7 inclusive of the plaintiff's complaint and incorporates those paragraphs herein by this reference as its answer to paragraph 16 of the plaintiff's complaint.

17. Fidelity Federal admits that it claims that plaintiff is in default. Except as expressly admitted herein, defendant Fidelity Federal denies each and every remaining allegation contained in paragraph 17 of the plaintiff's complaint.

18. Fidelity Federal denies each and every allegation contained in paragraph 18 of the plaintiff's complaint.

19. Fidelity Federal denies each and every allegation contained in paragraph 19 of the plaintiff's complaint.

20. Fidelity Federal admits that it recorded and served a Notice of Default and Election to Sell with respect to the subject property. Except as expressly admitted herein, Fidelity Federal denies each and every remaining allegation contained in paragraph 20 of the plaintiff's complaint and specifically denies that plaintiff has been damaged in the sum of $72,900.00 or any other amount whatsoever.

21. Fidelity Federal denies each and every allegation contained in paragraph 21 of the plaintiff's complaint.

22. Fidelity Federal denies each and every allegation contained in paragraph 22 of the plaintiff's complaint and specifically denies that plaintiff is entitled to punitive damages in the sum of $25,000,000.00 or any other amount whatsoever.

THIRD CAUSE OF ACTION

23. Fidelity Federal refers to and realleges its answers to paragraphs 1 through 14 inclusive of the plaintiff's complaint and incorporates those paragraphs herein by this reference as its answer to paragraph 23 of the plaintiff's complaint.

24. Fidelity Federal admits the allegations contained in paragraph 24 of the plaintiff's complaint.

25. Fidelity Federal denies each and every allegation contained in paragraph 25 of the plaintiff's complaint.

26. Fidelity Federal denies each and every allegation contained in paragraph 26 of the plaintiff's complaint.

27. Fidelity Federal denies each and every allegation contained in paragraph 27 of the plaintiff's complaint.

FIRST AFFIRMATIVE DEFENSE

28. Plaintiff's complaint fails to state sufficient facts to constitute a cause of action against these answering defendants.

SECOND AFFIRMATIVE DEFENSE

29. Fidelity Federal Savings and Loan Association is a federally chartered savings and loan association governed by the statutes of the United States and rules, regulations, and policies of the Federal Home Loan Bank Board as announced, adopted, or declared by the Bank Board pursuant to its statutory authority to regulate each and every aspect of the business of federal savings and loan associations on a nationally uniform basis. Pursuant to its statutory authority, the Federal Home Loan Bank Board has the power to authorize federal savings and loan associations to include within its notes and deeds of trust and to automatically enforce due-on-sale clauses. At all times relevant herein, the Federal Home Loan Bank Board has so exercised its statutory authority so as to preclude any attempted regulation by state authorities, whether by statute or court decision, from prohibiting federal savings and loan associations such as Fidelity Federal from automatically exercising due-on-sale clauses in notes and deeds of trust given in favor of Fidelity Federal as beneficiary with respect to loans secured by real property. By federal preemption under the supremacy clause of the United States Constitution, this Court is precluded from entering any finding that Fidelity Federal has violated Civil Code §711 or any other State enactment or policy pertaining to restraints on alienation by reason of Fidelity Federal's enforcement of the due-on-sale clause in the note and deed of trust given in favor of Fidelity Federal.

WHEREFORE, defendants Fidelity Federal Savings and Loan Association and Gateway Mortgage Corporation pray for judgment as follows:

1. That plaintiff take nothing by his complaint and that should any declaration be issued, that such declaration be that Fidelity Federal as a federally chartered savings and loan association is exempt from the operation of Civil Code §711 by reason of preemption under the supremacy clause of the United States Constitution.

2. For costs of suit.

3. For reasonable attorneys' fees.

4. For such other and further relief as this Court may deem just and proper.

Dated: April 26, 1979.

HAHN CAZIER & LEFF
WALTER L. BLACKWELL, III
By /s/ Andrew E. Katz
Andrew E. Katz
Attorneys for Defendants
Fidelity Federal Savings and
Loan Association and Gateway
Mortgage Corporation

Motion to Dismiss or Affirm

Office - Supreme Court, U.S.
FILED
NOV 23 1981
ALEXANDER L. STEVAS,
CLERK

NO. 81-750

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

APPELLANTS,

vs.

REGINALD D. de la CUESTA, et al.,

APPELLEES,

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.

APPELLANTS,

vs.

ALPHONSO MOORE, et al.,

APPELLEES.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

APPELLANTS,

vs.

JOHN D. WHITCOMBE,

APPELLEE.

ON APPEAL
FROM THE CALIFORNIA COURT OF APPEAL
FOURTH APPELLATE DISTRICT

MOTION TO AFFIRM OR DISMISS

FRED CRANE
ROBERT E. BOEHMER
MARK A. HILLER
JOHN MEYER

FRED CRANE
A PROFESSIONAL CORPORATION
3576 Arlington Avenue
Suite 106
Riverside, Calif. 92506
(714) 781-4700

ATTORNEYS FOR APPELLEES

I

QUESTIONS PRESENTED

The determination of appellees' Motion to Affirm or Dismiss depends upon a determination of the following issues:

1. Whether the Home Owners' Loan Act of 1933 occupies a field including the areas of real property and mortgages which are of fundamental state concern traditionally governed exclusively by state law, thus precluding the application of California Civil Code §711 to federal associations?
2. Whether Civil Code §711 conflicts with the Home Owners' Loan Act of 1933, or with regulations promulgated thereunder, to such a degree as to preclude its application to federal associations?
3. By including a clause in its deed of trust stating that the contract is governed by the law of jurisdiction in which the property is located, whether Fidelity Federal has thereby agreed to follow California law prohibiting unreasonable restraints on alienation, when the federal law commits the inclusion and enforcement of due-on-sale clauses to the contract between the borrower and lender?

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NO. 81-750

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

APPELLANTS,

vs.

REGINALD D. de la CUESTA, et al.,

APPELLEES,

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

APPELLANTS,

vs.

ALPHONSO MOORE, et al.,

APPELLEES.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

APPELLANTS,

vs.

JOHN D. WHITCOMBE,

APPELLEE.

MOTION TO AFFIRM OR DISMISS

STATEMENT OF THE CASE

In general, appellees have no quarrel with appellants' Statement of the Case. However, because 12 C.F.R. §545.6-11 (f) (now codified at 12 C.F.R. §545.8-3 (f)) by its own terms became effective July 31, 1976, the execution dates of the deeds of trust at issue here are relevant. The trust deeds at issue in the **Whitcombe** and **de la Cuesta** cases were executed on July 17, 1972 and January 18, 1971, respectively, prior to the effective date of 12 C.F.R. §545.6-11 (f) (hereinafter all references will be to 12 C.F.R. §545.8-3 (f) and (g)).

In addition, appellees take issue with appellants' characterization of appellees' position regarding the "law of the jurisdiction" clause and the Court of Appeal's decision regarding that clause. Neither appellees nor the Court of Appeal argued that the law of the jurisdiction clause made only state law applicable. Furthermore, neither appellees nor the Court of Appeal argued that the law of the jurisdiction clause "prevented" Bank Board regulations from governing. Appellees' contentions in this regard will be set forth *ante*.

I

MOTION TO AFFIRM

A. California Law Is Not Preempted By The Home Owners' Loan Act of 1933.

1. Since California's Prohibition of Unreasonable Restraints on Alienation Regulates an Area of Traditionally Local Concern, It Will Not Be Superseded Unless That Was the Clear and Manifest Purpose of Congress.

Whether a federal enactment preempts state law presents a question of congressional intent. **Jones v. Rath Packing Co.**, 430 U.S. 519, 525 (1977). State regulation in areas traditionally subject to local control[1] will not be precluded by a federal enactment "unless that was the clear and manifest purpose of Congress." **Rice v. Santa Fe Elevator Corp.**, 331 U.S. 218, 230 (1946).

In recent years this Court has repeatedly emphasized that preemption of state law is not favored "in the absence of persuasive reasons — either the nature of the regulated subject matter permits no other conclusion or that the Congress has unmistakably so ordained." **Florida Lime**

1/ In a long line of cases this Court has recognized that as a general rule, the areas of real property and mortgage law are governed by state law. See e.g., **Butner v. United States**, 440 U.S. 48, 55 (1979); **State Land Bd. v. Corvallis Sand & Gravel Co.**, 429 U.S. 363, 378 (1977); **United States v. Little Lake Misere Land Co.**, 412 U.S. 580, 591592 (1973); **Hoopeston Canning Co. v. Cullen**, 218 U.S. 313, 318 (1942); **Sunderland v. United States**, 266 U.S. 226, 232-233. (1924)

& Avocado Growers v. Paul, 373 U.S. 132, 147 (1963); **De Canas v. Bica,** 424 U.S. 351, 356(1976); **Chicago and Northwestern Transportation Co. v. Kalo Brick & Tile Co.,** _____ U.S. _____, _____, (1981); **Alessi v. Raybestor-Manhattan, Inc.,** _____ U.S. _____ , _____, (1981); **Commonwealth Edison Co. v. Montana,** _____ U.S. _____ , _____, (1981).

Even if Congress has the power to preclude the application of any state law whatsoever to federal associations, there is no rule which compels Congress to occupy the whole field. **Kelly v. Washington,** 302 U.S. 1, (1937).

> The [preemption] doctrine does not and could not in our federal system withdraw from the States either the "power to regulate where the activity regulated [is] a merely peripheral concern" of federal law (citation omitted), or the authority to legislate when Congress could have regulated "a distinctive part of a subject which is peculiarly adapted to local regulation . . . but did not," (citation omitted).
>
> **Chicago and Northwestern Transportation Co. v. Kalo Brick & Tile Co., supra,** _____ at _____.

This reluctance to find a total ouster of state authority "comports with the basic conception of federal law as interstitial in nature." Tribe, **American Constitutional Law,** 384, n.1 (1978).(2)

2/ See also Hart & Wechsler, **The Federal Courts and The Federal System** 470-471 (2nd Ed. 1973).

In addition, this reluctance to find a total ouster of state law preserves the state-federal balance from unintentional disturbance by Congress and unnecessary disturbance by the courts. **Jones v. Rath Packing Co., supra,** 430 U.S. at 525.(3) It is not a reflection of "doctrinaire localism", but is a reflection of the "presuppositions of our embracing federal system." **San Diego Building Trades Council v. Garmon,** 359 U.S. 236, 243 (1959).

2. **Congress Did Not Express a Clear and Manifest Purpose to Preclude the Applications of State Real Property and Mortgage Law to Federal Associations.**

In support of the claim that Congress intended the HOLA to supersede state real property and mortgage law, appellants rely on the broad power granted to the Federal Home Loan Bank Board(4) ("Bank Board") and the comprehensive character of federal regulations. This Court has rejected the contention that the requisite

3/ "[T]he state is powerless to remove the ill effects of our decision, while the national government, which has the ultimate power, remains free to remove the burden." **Penn Dairies, Inc. v. Milk Control Commission,** 318 U.S. 261, 275 (1943).

4/ "In order to provide local mutual thrift institutions... the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations', . . ." 12 U.S.C. §1464 (a) (1).

congressional intent may be inferred merely from the comprehensive character of the federal program. **New York State Department of Social Services v. Dublino,** 413 U.S. 405, 415 (1973); **De Canas v. Bica, supra,** 424 U.S. at 359-360 (1976).

Even if an intent to preempt may be inferred solely from a comprehensive federal scheme, this does not necessarily mean that the field preempted is coterminous with the area in which the Bank Board may regulate. The mere fact that Congress granted the Bank Board authority to "regulate" federal associations does not indicate that Congress intended to prohibit the application of any state law to federal associations. Cf., **Ray v. Atlantic Richfield Co.,** 435 U.S. 151, 168-169 (1978). Thus, even if the HOLA is broad enough to permit the Bank Board to regulate in the areas of real property and mortgages, this does not mean that Congress intended the Bank Board's authority in these areas to be exclusive.

The existence of a comprehensive scheme should not and does not serve as a litmus paper test of preemption. In this case, several factors indicate that a comprehensive scheme does not imply a congressional intent to preempt. California Civil Code §711 is a substantive rule of real property — an area traditionally governed by state law. Additionally, it is not aimed at associations or even at financial institutions; it is a statute of general applicability. Because it is a statute of general applicability, it is not "regulation" of federal associations. Cf., **New York**

Telephone Co. v. New York State Department of Labor, 44 U.S 519, 533, (1979).

It should also be noted that the Bank Board has not even attempted to regulate in the areas of real property and mortgages. The Bank Board has not regulated recording requirement, foreclosure proceedings, deficiency judgments, lien priorities, rights of redemption and the like. As the Court of Appeal pointed out, federal associations have always been governed by state real property and mortgage law (Appellants' Jurisdictional Statement, hereinafter "A.J.S.", p. 11a-12a). The HOLA and the regulations promulgated thereunder, far from being comprehensive, are nonexistent in the areas of real property and mortgages. The Court of Appeal's internal/external distinction gives effect to the considerations.

Appellants have not cited, nor have appellees discovered, a single decision rejecting the internal/external distinction.(5) On the contrary, at least two Circuit Courts of

5/ The decision in **Conference of Federal Savings and Loan Associations v. Stein,** 604 F. 2d 1256 (9th Cir. 1979) aff'd., 445 U.S. 921 (1980) does not reject the internal/external distinction. The court divided the state provisions into two categories:
(1) those provisions conferring substantive rights on borrowers and (2) those providing "regulatory control" over lenders. **Id.** at 1260. The court expressly declined to decide whether the first category of state laws was preempted. **Id.** Obviously this Court did not affirm a holding that the Circuit Court did not make. This Court's summary affirmance cannot be viewed as a rejection of the internal/external distinction. The statutes involved in **Stein** governed the internal affairs of the association.

Appeal have embraced the distinction. Federal law governs only the internal management of federal associations. **Gulf Federal Savings and Loan Association v. Federal Home Loan Bank Board,** 651 F. 2d 259, 266 (5th Cir. 1981); **Murphy v. Colonial Federal Savings and Loan Association,** 388 F. 2d 609, 612 (2nd Cir. 1967). Several district courts have also recognized the internal/external distinction. See **De Simone v. Warwick Federal Savings and Loan Association,** 482 F. Supp. 1190, 1194 (D.R.I. 1980); **City Federal Savings and Loan Association v. Crowley,** 393 F. Supp. 644, 655-656 (E.D. Wis. 1975); **Rettig v. Arlington Heights Federal Savings and Loan Association,** 405 F. Supp. 819, 823 (N.D. Ill. 1975).

While it is true that many courts have parroted the language of the court in **People v. Coast Federal Savings and Loan Association,** 98 F. Supp. 311 (S.D. Cal. 1951), that "[T]he Board has adopted comprehensive rules and regulations concerning the powers of every federal savings and loan association from its cradle to its corporate grave" (**id,** at 316), it is a mistake to read this language literally. As this Court observed in **San Diego Building Trades Council v. Garmon, supra:**

> In the course of a process of tentative, fragmentary illumination carried on over more than a decade during which the writers of opinions almost inevitably, because unconsciously, focus their primary attention on the facts of particular

situations, language may have been used or views implied which do not completely harmonize with the clear pattern which the decisions have evolved. **Id.** at 244.

The Court of Appeal in the within cases recognized the "clear pattern." While many cases contain broad statements of the preemptive effect of the HOLA, the courts in those cases were not faced with a question of state real property or mortgage law. Those cases dealt instead with such diverse issues as control over the establishment of branch offices, **North Arlington National Bank v. Kearny Federal Savings and Loan Association,** 187 F. 2d 564 (3rd Cir. 1951) *cert. denied* 342 U.S. 816 (1951); **Lyons Savings and Loan Association v. Federal Home Loan Bank Board,** 377 F. Supp. 11 (N.D., Ill. 1974); the means of communication between the members of an association, **Kupiec v. Republic Federal Savings and Loan Association,** 512 F. 2d 147 (7th Cir. 1975); and the use of mobile savings and loan facilities, **Central Savings and Loan Association of Chariton v. Federal Home Loan Bank Board,**422 F. 2d 504 (8th Cir. 1970).

The Court of Appeal's internal/external distinction demonstrates the proper "respect for the separate spheres of governmental authority preserved in our federalist system." **Alessi v. Raybestor-Manhattan, Inc., supra,** _____U.S. at_____. State real property and mortgage law has ancient roots and has evolved over time into an intricate and interrelated body of law carefully balancing

competing and conflicting interests and goals. The mere fact that Congress granted the Bank Board broad power to regulate federal associations is not sufficient evidence of a "clear and manifest purpose of Congress" to sweep all this away. Regulation of restraints on alienation is at best only a peripheral concern of the HOLA. It is not within the central aim of the HOLA; it is peculiarly adapted to local regulation.

3. **California's Prohibition of Restraints on Alienation Does Not Conflict with the HOLA.**

Appellants' conflict argument is little more than a restatement of their occupation of the field argument. They assert that since Congress intended the jurisdiction of the Bank Board to be exclusive, the application of California Code §711 conflicts with the HOLA. The simple response is that Congress did not intend to preclude the application of state real property and mortgage law.

The suggestion that the HOLA preempts any state statute which adversely affects a federal association's profitability is specious. No specific statutory provision guarantees a federal association's profitability. Appellants cannot rest on general statements of national policy. This Court rejected a similar argument in **Commonwealth Edison Co. v. Montana, supra,** _____U.S._____ at_____. In that decision, this Court rejected the argument that federal statutes encouraging the use of coal preempted any state statute which adversely affected the

use of coal. **Id.** Appellants' argument should also be rejected.

Moreover, the application of Civil Code §711 does no more than that which is authorized by 12 C.F.R. §545.8-3 (f). This regulation mandates neither the inclusion nor enforcement of a due-on-sale clause. Since it is permissible for any and all federal associations to contract to enforce the due-on-sale clause only when a transfer impairs the security, a state law which achieves this same result cannot be in conflict with the HOLA.

B. **California's Prohibition Of Restraints On Alienation Does Not Conflict With Any Regulation Promulgated By The Bank Board.**

1. **Occupation of the Field by Administrative Fiat Has Never Been Sustained.**

Absent congressional intent to supersede even harmonious state law, state law is superseded only to the extent that it actually conflicts with a federal statute. **Katherine Gibbs. Inc. v. F.T.C.,**612 F. 2d 658, 666-667 (2d Cir. 1979). A federal agency may not, under the guise of interpretation, expand or restrict the operation of a federal statute. See e.g., **U.S. v. Colamaro,** 354 U.S. 351 (1957); **Neuberger v. Commissioner,** 311 U.S. 83 (1940); **Texas & Pacific Railroad Co. v. U.S.,** 289 U. S. 627 (1933).

If Congress intends to exclude even harmonious state regulation, any attempt by a federal agency to accomplish this same goal is superfluous. If Congress does not intend to exclude even harmonious state regulations, any attempt by a federal agency to do so is beyond its power. The Court of Appeal correctly observed the difference between regulatory agency enactments and the necessary *Congressional intent* to preempt;

> The decision whether to displace state law is a fundamental one going to the very fabric of federalism; thus, the decision is one to be made by the people through their elected representatives in Congress rather than by agencies or tribunals insulated from democratic pressures. (Citations omitted.)
> (A.J.S. p. 15a-16a).

Thus, the Bank Board's regulations can have no greater preemptive effect than that which would normally follow from inconsistency or repugnancy.

Appellants agree with the Court of Appeal that the "unifying inquiry is: Has Congress in one manner or another intended federal law to control?" (A.J.S. p. 12) Yet, appellants nonetheless suggest that if the Bank Board intends preemption, preemption occurs even in the absence of a conflict between state and federal law. This suggestion is totally without support.

On many occasions this Court has held that in the absence of a Congressional intent to preclude the application of state law, state law is void only to the extent that it

actually conflicts with a federal enactment. See e.g., **Ray v. Atlantic Richfield, supra,** 435 U.S. at 158. This Court has never suggested that a federal agency could preclude the application of harmonious state law when Congress did not so intend.

This Court's decision in **United States v. Shimer,** 367 U.S. 374 (1961) does not hold to the contrary. This Court phrased the question presented as whether "the application of state law to determine the Administration's obligation to Excelsior is *inconsistent* with the Regulations prescribed by the agency charged with administering the Servicemen's Readjustment Act." (Emphasis added). **Id.** at 377. This Court was not presented with the question whether the application of state law not inconsistent with federal regulations was permissible.

2. **The Applications of California Civil Code §711 to Federal Association Does Not Conflict with 12 C.F.R. §545.8-3 (f) and (g).**

As a preliminary matter, 12 C.F.R. §545.8-3 (f) is not applicable to either the *Whitcombe* or *de la Cuesta* deeds of trust. By its own terms this regulation was not effective until July 31, 1976. (See Federal Home Loan Bank Board Resolution 76-296, A.J.S. p. 44a). The deed of trust in **Whitcombe v. Fidelity Federal Savings and Loan Association** was executed by the trustor on July 17, 1972. The deed of trust in **de la Cuesta v. Fidelity Federal Savings and Loan Associations** was executed on January 18, 1971. Thus, 12 C.F.R. § 545.8-3 (f) and (g)

("the due-on-sale regulation") has no application to the **Whitcombe** and **de la Cuesta** cases.

As discussed *ante*, the judgment of the Court of Appeal in the **Moore** case rests on an adequate non-federal basis. Thus, this Court need not reach the issue of whether Civil Code §711 conflicts with the due-on-sale regulation.

In any event, the Court of Appeal correctly followed the controlling precedent in determining that Civil Code §711 does not conflict with the due-on-sale regulation. The Court of Appeal concluded that there was no conflict since it is possible for federal associations to comply with both state and federal law, relying on this Court's decision in **Florida Lime and Avocado Growers, Inc. v. Paul, supra.**

Appellants suggest that the Court of Appeal was mistaken in its reliance on **Florida Lime and Avocado Growers, Inc., supra,** and that the Court of Appeal should have followed **Meyers v. Beverly Hills Federal Savings and Loan Association,** 499 F. 2d 1145 (9th Cir. 1974). However, in a more recent case the Ninth Circuit employed reasoning analogous to the Court of Appeal. In **Credit Data of Arizona, Inc. v. State of Arizona,** 602 F. 2d 195 (9th Cir. 1979), that court upheld the application of a state law prohibiting a credit agency from imposing a fee for disclosing its sources of credit information, even thought the federal Fair Credit Reporting Act explicitly permitted such a charge. **Id.** at 198. In reaching this result, the court relied upon this Court's reasoning in **Jones v.**

Rath Packing, supra, Id. In **Jones**, this Court reasoned that a state statute is not inconsistent with a federal enactment when it is possible to comply with both the state and federal rules without triggering federal enforcement action. **Jones v. Rath Packing, supra,** 430 U.S. at 540.

In **Goldstein v. California**, 412 U.S. 546 (1973), this Court held that state legislation, to be preempted, must be "absolutely and totally contradictory and repugnant." **Id.** at 533. Civil Code §711 cannot be characterized as such. This is especially true given the language of the Bank Board's due-on-sale regulation. That regulation authorizes the inclusion and enforcement of a due-on-sale clause as a matter of contract.

In **De Simone v. Warwick Federal Savings and Loan Association, supra,** the court construed 12 C.F.R. §545.6-11 (d) (now codified at 12 C.F.R. §545.8-3 (d)), governing the imposition of late charges. This regulation contains a form of language identical to that in the due-on-sale regulation, and provides that an association may include a late charge provision in its loan instrument "as a matter of contract" and that the "assessment, imposition and collection of a late charge shall be exclusively governed by the terms of the contract." The court concluded that the regulation "seems to indicate a strong intent to leave late charges to the contract, and not to detailed federal supervision." **Id.,** 482 F. Supp. at 1193. The court further held that any violation of the terms of the contract by

the association would not constitute a regulatory violation. **Id.** at 1194.

Similarly, the due-on-sale regulation leaves due-on-sale clauses to the contract and not to detailed federal supervision. Commercial agreements are traditionally governed by the states. **Aronson v. Quick Point Pencil Co.,** 440 U.S. 257 (1979). The "invalidation of contract clauses held repugnant to state public policy is a proper exercise of the state judicial function." **Mariniella v. Shell Oil Company,** 511 F. 2d 853, 858 (3rd Cir. 1975). Since the due-on-sale clause merely permits the inclusion and enforcement of a due-on-sale clause in a federal association's loan documents as a matter of contract, California's prohibition of its use when it restrains the alienation of property does not constitute an "actual conflict between the two schemes that they both cannot stand in the same area." **Florida Lime and Avocado Growers v. Paul, supra,** 379 U.S. at 141.

The mere fact that federal law permits the use of a due-on-sale clause does not necessarily mean that any state law which places limitations on its use is invalid. This Court has upheld the application to national banks of a state statute prohibiting the use of real property as security for a pre-existing debt, even though federal law specifically allowed national banks to use real property as security for pre-existing debts. **McClellan v. Chipman,** 164 U.S. 347 (1896). Cf., **Huron Portland Cement Co. v. Detroit,**362 U.S. 440, 444-447 (1960).

II

MOTION TO DISMISS

A. The Judgment Of The Court Of Appeal In The Moore And Whitcombe Cases Rests On An Independent Non-Federal Basis In That The Court Of Appeal Found That Appellant Fidelity Federal Contracted To Follow California Law Prohibiting Restraints On Alienation.

The Court of Appeal held that by the inclusion of paragraph 15(6) in the **Moore** and **Whitcombe** deeds of trust, appellant Fidelity Federal expressed an unmistakable intent to follow California law governing restraints on alienation. Even if this Court agrees that Civil Code §711 is preempted, the Court of Appeal's judgment must nevertheless stand.

6/ Paragraph 15 reads as follows:

"15. Uniform Deed of Trust; Governing Law; Severability. This form of deed of trust combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Deed of Trust or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Deed of Trust or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Deed of Trust and the Note are declared to be severable."

Appellants contend that paragraph 15 simply refers to state law which includes the preemption principle. This begs the question of the effect of paragraph 15.

Even if appellants correctly assert that federal law preempts, this means no more than state law does not apply of its own force. It is indisputable that under federal law a federal association can contract to enforce the due-on-sale clause only when its security interest is impaired. Thus, the question decided by the Court of Appeal was whether paragraph 15 had this effect, [7] and not as appellants suggest, whether this paragraph prevents federal regulations from governing.

The Court of Appeal's construction of paragraph 15, contained in a local contract according to local law, is conclusive and does not raise a substantial federal question. **Black v. Cutter Laboratories**, 351 U.S. 292, 299 (1956).

It is true that this Court will "examine the contract only to make certain that the non-federal ground of decision is not so colorable or unsubstantial as to be in effect an evasion of the constitutional issue." **Memphis Natural Gas Co. v. Beeler**, 315 U.S. 649, 654 (1941). The Court of Appeal's interpretation of the effect of paragraph 15 is neither bizarre nor unsubstantial. Similar results have

7/ As applied to the due-on-sale clause, paragraph 15 is not a true choice-of-law provision, but merely a device for incorporating extrinsic material by reference. See, Restatement (Second) Conflicts of Law, §187, comment c.

been reached even in cases where the federal fisc was directly involved. See e.g., **United States v. Yazell,** 382 U.S. 341 (1966) and **United States v. Stewart,** 523 F. 2d 1070 (9th Cir. 1975). The Court of Appeal applied the well established rule of construction that ambiguities are construed against the drafter, a rule which is applied as a matter of federal law, **Bituminous Casualty Corp. v. Lynn,** 503 F. 2d 636, 640-641 (6th Cir. 1974), even when the drafter is the United States. **Kenneth Reed Construction Corp. v. United States,** 475 F. 2d 583, 587 (Ct. Cl. 1973) **Firestone Tire and Rubber Co. v. United States,** 444 F. 2d 547, 551 (Ct. Cl. 1971).

CONCLUSION

The prior cases on preemption clearly indicate that the mere delegation of power to the Bank Board to "regulate" federal associations is not sufficient to preclude the application of state real property and mortgage law to federal associations. Furthermore, appellants have failed to present a substantial claim that California Civil Code §711 conflicts with the federal scheme.

Even if this Court disagrees, and believes that these issues deserve plenary consideration, the appeals in the **Moore** and **Whitcombe** cases should be dismissed because the judgment of the Court of Appeal as to these cases rests on an adequate non federal basis.

Dated: November 18, 1981

Respectfully submitted

FRED CRANE
A PROFESSIONAL CORPORATION

FRED CRANE
ROBERT E. BOEHMER
MARK A. HILLER
JOHN MEYER

ATTORNEYS FOR APPELLEES

PROOF OF SERVICE

STATE OF CALIFORNIA) ss:
COUNTY OF RIVERSIDE)

I am a citizen of the United States and a resident of the County aforesaid; I am over the age of eighteen years and not a party to the within entitled action; my business address is 612 North Bush Street, Santa Ana, California 92701.

On November 19, 1981, I served the within MOTION TO AFFIRM OR DISMISS on the interested parties in said action, by placing a true copy in each of 3 sealed envelopes, with postage thereon fully prepaid, in the United States mail at Santa Ana, California, adressed as follows:

Clerk, Court of Appeal
4th Appellate District
303 West Third Street
San Bernardino, CA 92401

Clerk of the Superior Court
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Santa Ana, CA 92707

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I certify under penalty of perjury that the foregoing is true and correct.

EXECUTED on November 19, 1981, at Santa Ana, California.

JACK GALLAGHER

Appellant's Reply Brief

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No. 81-750

IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

REGINALD D. de la CUESTA, *et al.*,
Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

ALPHONSO MOORE, *et al.*,
Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

JOHN D. WHITCOMBE,
Appellee.

**On Appeal from the California Court of Appeal,
Fourth Appellate District.**

BRIEF OPPOSING MOTION TO AFFIRM OR DISMISS.

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Appellee.

BRIEF OPPOSING MOTION TO AFFIRM OR DISMISS.

Introduction.

The Federal Home Loan Bank Board ("Bank Board"), and not the several states, has the ultimate authority to regulate the lender/borrower relationship between federal associations it has chartered and those who borrow money

secured by real property from federal associations. In respect to this action, the Bank Board has deliberately elected, by regulation, to exclude from any state control the exercise of due-on-sale clauses by federal associations.[1] Despite the fact that the Bank Board's regulations leave no room for exercise of state authority, the California Court of Appeal held that it was not the intention of Congress in enacting the Home Owners Loan Act of 1933 ("HOLA") to provide authority to the Bank Board over due-on-sale clauses in mortgage contracts between federal associations and their borrowers. The Appellees have moved to affirm, arguing that the decision of that Court is correct.[2] Appellants will demonstrate in this brief that Congress plainly has conferred on the Bank Board the authority to regulate the due-on-sale clause practices of federal associations.

The Appellees have also moved to dismiss the appeal, arguing that the decision of the state court rests upon an adequate and independent state ground. In support, Appellees cite the waiver of federal preemption assertedly contained in Paragraph 15 of the deed of trust. This contention is neither adequate nor an independent state ground (as waiver of a federal right is itself a federal question), and, therefore, will not be extensively addressed herein.

Congress Has Given the Bank Board Ample Authority to Adopt Due-on-Sale Regulations.

In their motion to affirm the Appellees overlook the history of the HOLA which demonstrates that Congress intended by the HOLA that the Bank Board exercise plenary authority over federal associations.

The HOLA is a product of the Depression and represents a response of the Congress to the misery of the wave of

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[1] 12 C.F.R. § 545.8-3(f) and (g), and 12 C.F.R. § 556.9(f).

[2] The Appellees have not moved to affirm on the basis that appellate jurisdiction has been improperly invoked, or that the issues presented are not of great national interest.

home foreclosures and savings and loan association failures then occurring. Congress sought not only to protect the millions whose homes then faced foreclosure, but also sought to insure that the financing conditions which exacerbated the foreclosure problems not be repeated. The short-term problem, prevention of foreclosure, was solved by the mortgage refinance operations of the Home Owners Loan Corporation. *See West Helena Savings and Loan Assn. v. Federal Home Loan Bank Board*, 417 F. Supp. 220 (E.D. Ark. 1976), *aff'd*, 553 F. 2d 1175 (8th Cir. 1977), quoted in Appellants' Jurisdictional Statement at 19-20. Congress chose to solve the long-term problem by empowering the Bank Board to create and regulate federal savings and loan associations in a manner consistent with the "best practices of local mutual thrift and home-financing institutions in the United States." 12 U.S.C. § 1464(a). Congress thus assured that mortgage funds would be available upon terms other than those permitted or required by state laws which had aggravated the Depression for homeowners and depositors. *Conference of Federal Savings and Loan Associations v. Stein*, 604 F. 2d 1256, 1257-1258 (9th Cir. 1979), *aff'd*, 445 U.S. 921 (1980). *See also Glendale Federal Savings and Loan Association v. Fox*, 459 F. Supp. 903, 908-909 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. 1981); and *West Helena, supra*.

Heretofore this broad mandate has been consistently interpreted as authorizing the Bank Board to select those practices it deems best for the health and growth of the federal savings and loan system and to apply them on a nationally uniform basis to the exclusion of those state practices which conflict.

> The statute is one of the type which states a policy, provides for the project under consideration, lays down some general rules and prohibitions and leaves details to the Board which is authorized by Section 1463. The statutory delegation of authority to the Board has been held constitutional.

* * *

> The Board is authorized in Section 1464(a) to issue charters for federal savings and loan associations "giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States." Here is an area where the Board is given the duty and authority to make policy. It is supposed to find out what the practices of these institutions are and give primary consideration to the best ones.
>
> *North Arlington National Bank v. Kearny Federal Savings & Loan Association*, 187 F. 2d 564, 565 (3d Cir. 1951).

See also Central Savings and Loan Association of Chariton, Iowa v. Federal Home Loan Bank Board, 293 F. Supp. 617, 621-622 (S.D. Iowa 1969), *aff'd*, 422 F. 2d 504, 506 (8th Cir. 1970); and, *Lyons Savings and Loan Association v. Federal Home Loan Bank Board*, 377 F. Supp. 11, 17-18 (N.D. Ill. 1974).

The Bank Board has thus been directed by Congress in the HOLA to create a federal savings and loan system, and to regulate that system in accordance with what the Bank Board determines to be the best practices of the thrift industry. The Bank Board, we submit, under the power given to it by Congress could, in a proper case, either permit or prohibit the exercise of due-on-sale clauses by a federal association. The Bank Board concluded that the ability to automatically enforce a due-on-sale clause was beneficial to the fiscal well-being of federal associations and the borrowing public, and, therefore, adopted regulations which permit this practice. *See* Federal Home Loan Bank Board Resolution No. 75-647 (July 30, 1975) at 27; and Federal Home Loan Bank Board Resolution No. 76-100 (February 6, 1976). The Bank Board acted to ensure that this "best practice" was available to its chartered associations by adopting the due-on-sale regulations here in issue to the

exclusion of contrary state law. 12 C.F.R. § 545.8-3(f), and 12 C.F.R. § 556.9(f).[3]

This and other Courts have recognized that HOLA grants the Bank Board power to regulate the lender/borrower relationships of federal associations to the exclusion of state law. *See e.g. Conference of Federal Savings and Loan Associations v. Stein*, 604 F. 2d 1256 (9th Cir. 1979), *aff'd*, 445 U.S. 921 (1980) (reporting and notice requirements regarding possible discriminatory lending practices); *First Federal Savings and Loan Association of Boston v. Greenwald*, 591 F. 2d 417, 425 (1st Cir. 1979) (payment of interest on escrow accounts); *Kaski v. First Federal Savings and Loan Association of Madison*, 72 Wis. 2d 132, 135, 240 N.W. 2d 367 (1976) (validity of variable interest rate loans); and *Meyers v. Beverly Hills Federal Savings and Loan Association*, 499 F. 2d 1145, 1147 (9th Cir. 1974) (prepayment penalties). The Appellees apparently concede that the Bank Board has the authority to assume exclusive control over one or more of the foregoing, to the exclusion of state law. *See* Motion to Affirm at 7 and 9. The recognition of that power as to due-on-sale clauses should be self-evident.[4]

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[3]Although 12 U.S.C. § 1464(a) has been amended many times since 1976, Congress has not acted to undermine the Bank Board's due-on-sale regulations. *See* Appellants' Jurisdictional Statement at 15, footnote 11 and accompanying text.

[4]The Appellees' internal/external distinction (Motion to Affirm at 7-9) is undercut by *Kaski* where the Court recognized that the lending practices of a federal association directly affect its internal operation. "The regulation of loan practices directly affects the internal management and operations of federal associations and therefore requires uniform federal control." 72 Wis. 2d at 141-142. *See also Meyers, supra*, where the Bank Board's loan pre-payment regulations were held to preempt state law. Further, most federal associations are mutual associations. Hence, the lending relationship is one between the association and a member of the association. 12 U.S.C. § 1464(b)(1). Thus even if the internal/external distinction had any validity the lending relationship is internal.

The Appellees' attempt to distinguish *Meyers, supra*, (Motion to Affirm at 14) by arguing that it was called into question in 1979 by a subsequent Ninth Circuit decision fails due to the Ninth Circuit's later decision in *Conference* wherein *Meyers* was cited as controlling and was wholeheartedly embraced. 604 F. 2d at 1260.

Because the Bank Board's power to regulate the lender/borrower relationship is patent, the Appellees' Motion to Affirm should be denied, and the California Court of Appeal's decision should be summarily reversed.

The Asserted Importance to California of Civil Code § 711 Cannot Prevent Preemption.

Time and again the Appellees, in their Motion to Affirm, argue that Civil Code § 711 as construed by *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978), should not be preempted by the federal due-on-sale regulations because that section is an important part of the California law of mortgages and real property. Their argument was conclusively answered by this Court in *Free v. Bland*, 369 U.S. 663, 666 (1962), (where federal regulations applied a rule of survivorship different than the state law rule):

> The relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the Framers of our Constitution provided that the federal law must prevail. Article VI, clause 2. This principle was made clear by Chief Justice Marshall when he stated for the Court that any state law, however clearly within a State's acknowledged power, which interferes with or is contrary to federal law, must yield.

Notwithstanding Appellees' artful attempt to demonstrate that Civil Code § 711 as interpreted in *Wellenkamp, supra*, does not conflict with the Bank Board regulations it is incontrovertible that federal regulations expressly permit Appellants to do that which state law flatly denies. Federal law permits federal associations to exercise a due-on-sale clause automatically upon an unconsented-to transfer of property. California state law permits an association to exercise a due-on-sale clause only if the association can affirmatively demonstrate that the transfer impairs its security interest. Fur-

thermore, it is indisputable that the Bank Board regulations were not intended to and do not provide for the exercise of any authority by any state over the due-on-sale practices of federal associations.

The Judgment of the Court of Appeal in Moore and Whitcombe Does Not Rest on an Independent and Adequate State Ground.

The Appellees' Motion to Dismiss as to Appellees Whitcombe and Moore is premised on their contention that Paragraph 15 of the Federal Home Loan Mortgage Corporation ("FHLMC") uniform deed of trust represents in effect a waiver of preemptive federal law.[5] The Appellees then conclude that waiver is a state law issue precluding review by this Court.[6]

The issue of whether a federal lender by contract has waived a federal right properly is viewed as one of federal, not state law. In *Dice v. Akron, Canton, and Youngstown R. Co.*, 342 U.S. 359 (1952) this Court stated "the validity of releases under the Federal Employers Liability Act raises a federal question to be determined by federal rather than state law." *Id.* at 361. This Court continued, adding, ". . . only if federal law controls can the federal Act be given that uniform application throughout the country essential to effectuate its purpose." *Id.*

That federal law should control the disposition of the effect of Paragraph 15 is particularly the case here since it has been held that federal law should govern the interpre-

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[5]The *Whitcombe* case did not involve a deed of trust with a Paragraph 15 "law of the jurisdiction" clause, notwithstanding the California Court's refusal to recognize that fact. The de la Cuesta deed of trust also does not contain a "law of the jurisdiction" clause.

[6]The California Court's discussion of the "law of the jurisdiction" clause is obiter dicta, since after finding the federal regulations were not preemptive it was totally unnecessary to its decision that it reach the issue of waiver which was purportedly presented by the presence of the "law of the jurisdiction" clause.

tation of the regulations issued by the Bank Board relating to the operation of federal associations. *See e.g., Rettig v. Arlington Heights Fed. Savings and Loan Association*, 405 F. Supp. 819, 826 (W.D. Ill. 1975), where the court stated:

> The consistency and universality inherent in applying a single federal standard to the federal savings and loan system, whether it be statutory, regulatory, or derived from federal common law, is in keeping with the underlying objective of HOLA, which contemplates a uniform set of policies for federally chartered associations which does not vary with quirks of local law.

Thus, the effect of a nationally uniform clause in a document created by a federal entity (the FHLMC),[7] for use by a federally chartered association, on rights claimed by the association as guaranteed by federal regulations, is most appropriately treated as a federal question. The Motion to Dismiss should be denied.

The Bank Board's Regulation of Due-on-Sale Clauses Applies to Pre-1976 Loans.

Appellees claim that because the deeds of trust involved in the *Whitcombe* and *de la Cuesta* cases were executed prior to the 1976 effective date of the Bank Board regulations that the due-on-sale clauses found in those deeds of trust are not subject to the Bank Board's regulations. Appellees' claim is incorrect, for the Bank Board regulations merely codified what had been consistently the policy and position of the Bank Board.[8] *See*, 12 C.F.R. § 545.8-3(f);

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[7]The federal role in creating the secondary mortgage market, its national importance, and the FHLMC role therein (for which the deed of trust in question was created) is discussed in the Bank Board's Amicus Brief at 9-10.

[8]12 C.F.R. § 545.8-3(f) begins: "An association *continues to have* the power to include . . . [an *automatic* due-on-sale clause]." (emphasis added) 12 C.F.R. § 545.8-3 by its own terms suggests it applies to *all* loans by a federal association because its very language carves out an exception for *only* post-July 1976 loans meeting 12 C.F.R. § 545.8-3(g) criteria.

Bank Board Resolution 75-647; *Cf., Derenco, Inc. v. Benjamin Franklin Savings and Loan Ass'n.*, 577 P. 2d 477 (Or. 1978) (Bank Board regulation relieved association of obligation to pay compensation under state law for the use of escrowed funds after the June 14, 1975 effective date of preemptive federal regulations, even as to escrow accounts created prior to that date).

Furthermore, the Whitcombe and de la Cuesta deeds of trust were executed at a time when even California law permitted due-on-sale clauses to be automatically exercised on transfers of property. *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 38 Cal. Rptr. 505 (1964), overruled by *Wellenkamp, supra*, 21 Cal. 3d at 953. The contractual right to accelerate the balance due upon sale was confirmed by the 1976 Bank Board regulations, and thereby also made subject to exclusive federal control. The California *Wellenkamp* decision was not announced until over two years later, in August, 1978. By then the Whitcombe and de la Cuesta deeds of trust were already solidly entrenched as a matter subject only to federal law.

Conclusion.

Congress, having created federal associations and thereby possessing the power to regulate the lending practices of federal associations has by the HOLA validly delegated that power to the Bank Board. The Bank Board acted within that power when it asserted exclusive authority over the due-on-sale clause practices of federal associations. State law purporting to apply within the realm from which it has been excluded by federal regulation, is therefore preempted. Further the decision below as to the effect of Paragraph 15 is not based upon an independent and adequate state ground. Consequently, the Motion to Affirm or Dismiss should be

denied, and this Court should summarily reverse the California Court of Appeal's decision.

Respectfully submitted.

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AMICUS CURIAE BRIEF OF THE SECRETARY OF THE BUSINESS, TRANSPORTATION AND HOUSING AGENCY OF THE STATE OF CALIFORNIA IN SUPPORT OF THE MOTION TO DISMISS OR AFFIRM

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No. .....

IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,
Appellants,

vs.

REGINALD D. DE LA CUESTA, et al.,
Appellees,

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,
Appellants,

vs.

ALPHONSO MOORE, et al.,
Appellees,

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,
Appellants,

vs.

JOHN D. WHITCOMBE,
Appellee.

On Appeal from the California Court of Appeal, Fourth Appellant District.

AMICUS CURIAE BRIEF OF THE SECRETARY OF THE BUSINESS, TRANSPORTATION AND HOUSING AGENCY OF THE STATE OF CALIFORNIA IN SUPPORT OF THE MOTION TO DISMISS OR AFFIRM

I. INTEREST OF THE *AMICUS CURIAE.*

The Secretary of the Business, Transportation and Housing Agency of the State of California ("Secretary" or "*Amicus*") files this *Amicus Curiae* brief in support of the Motion to Dismiss or Affirm the Judgment of the California Court of Appeal.

The Secretary has in this and other related cases opposed the notion that lending institutions making loans in California, secured by California real estate and utilizing California corporations as trustees, are somehow immune from state real property and debtor protection laws, just because the institution happens to have a federal charter.

The Secretary is particularly concerned with the adverse effects that preemption would have on California. First, it is basically unfair because borrowers have not known that they would have fewer rights when they borrowed from a federally chartered association rather than from a state association. Second, state associations are converting to federal associations simply to escape the application of state laws, thus jeopardizing California's role with respect to financial institutions in this state. Third, federally chartered associations should not have an advantage over state chartered associations, especially in view of the fact that state law expressly grants to federal associations "all the rights, powers, and privileges . . . [and] exemptions and immunities" granted to state chartered associations. Cal. Fin. Code § 11000. Fourth, if federally chartered associations are immune from the state laws involved in this case, then they may be immune from other state laws relating to their lending activities and perhaps from other state laws such as zoning, health and safety and even criminal laws.[1] Fifth, the Federal Home Loan Bank Board ("Board") a non-elected federal administrative agency should not be able to cause unpredictability and confusion by suddenly purporting to nullify historic state real property and contract laws. Sixth, federally chartered associations should not be able to take advantage of certain state laws concerning their real property

[1] There are many state laws which unquestionably apply to federally chartered institutions. These would include health, safety and wage laws, as well as various real property laws (e.g. antideficiency laws). These laws apply to all employers and institutions doing business in California, including those that are federally-chartered. These laws do not "regulate" the federal associations.

transactions and even provide in their lending instruments for the application of state laws, while avoiding the application of some state laws.

For all of the foregoing reasons, the Secretary has an interest in the subject matter of this action.

II. SUMMARY OF ARGUMENT.

California federally chartered savings and loan associations make loans in California secured by California real estate and utilize California trustees, California law and California procedure. Accordingly, those associations should not be immune from the application of historic California real property law dealing with the transfer of real property in California—in this case the prohibition of restraints on alienation, which prohibition equitably restricts the enforcement of the due-on-sale clause in a deed of trust. The legislative history and the application of the Federal Home Owner's Loan Act of 1933 (Title 12 U.S.C. § 1461 *et seq.*) ("HOLA") demonstrates that Congress never intended such preemption. There is no conflict between state and federal law. Regulations of the Board simply authorize the use of the due-on-sale clause. California allows its use also but restricts its enforcement in certain cases. Authorization for use of a due-on-sale clause by a Board regulation does not result in preemption. The Board has not and cannot by resolution or regulation preempt historic state real property law when such preemption is not provided for or authorized by Congress.

The federally chartered associations have provided in their lending documents for the application of California law. Accordingly, they have waived whatever rights they may have by virtue of the preemption doctrine.

California appellate courts have held that California laws relating to restraints of alienation apply to federal associations. This issue can generally only be resolved by state courts since

there is no federal jurisdiction over a claim just becuase there is a defense of federal preemption. This case arose by way of a summary judgment without any factual showing of the operation of federal and state laws. There are recent laws granting federal savings and loan associations many devices to update their loan portfolios, and there is now proposed federal legislation to expressly override state law. Thus, this case does not present a substantial federal question.

III. ARGUMENT.

A. FEDERALLY CHARTERED ASSOCIATIONS SHOULD NOT BE IMMUNE FROM STATE LAWS CONCERNING REAL PROPERTY TRANSACTIONS BETWEEN THE ASSOCIATIONS AND OTHERS.

(i) FACTS.

California has, by statute enacted the ancient common law restrictions on restraints on alienation of real property. Calif. Civil Code § 711; *see* 6 Powell on Real Property 2 (1979); Comment, *Coast Bank v. Minderhout and the Reasonable Restraint on Alienation: Creature of Commercial Ambiguity,* 12 UCLA L. Rev. 954, 955-56 (1965).

The California Supreme Court has held that enforcement of a due-on-encumbrance clause or a due-on-sale clause is an unreasonable restraint on alienation when not necessary to protect the lender's security, and that such enforcement violates common and statutory law. *La Sala v. American Sav. & Loan Assn.,* 5 Cal.3d 864 (971); *Tucker v. Lassen Sav. & Loan Assn.,* 12 Cal.3d 629 (1974); *Wellenkamp v. Bank of America,* 21 Cal.3d 943 (1978). *See also Brown v. Avemco Investment Corp.,* 603 F.2d 1367 (9th Cir. 1979).

Federally-chartered savings and loans generally do business only in one state, and, thus, are not subject to conflicting state regulations.[2]

In California, the deeds of trust of the federal associations are recorded pursuant to California law. These recorded deeds of trust generally refer to a fictitious deed of trust recorded by a California corporation as trustee. That recording and the incorporation by reference of the fictitious deed are accomplished under the provisions of California Civil Code § 2952.

In the event of default, the federal association directs the trustee, a California corporation (presumably not subject to the control of the Board) to file a Notice of Default and Election to Sell, a procedure authorized by California Civil Code § 2924b. Accordingly, the actual enforcement of the due-on-sale clause is done by a California corporation—not by the federally chartered association. More importantly, the security in question is California property and generally the parties are California property owners or consumers.

As noted by the court below, the deed of trust often provides for the application of state law. Thus government agencies that purchase the mortgage instruments issue uniform deeds of trust that provide that they "shall be governed by the law of the jurisdiction in which the property is located." See Federal home Loan Mortgage Corp. Seller's Guide, § 1.407 at p. 110.[3] Indeed, the deeds of trust and notes of federal associations often refer to California law.

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[2] 12 C.F.R. 545.8-6 (1980) [and proposed 556.5(a)(3) in 45 F.R. 31121 (May 12, 1980)]. There are a few savings and loans which, by reason of their preexisting status upon conversion have branches outside their home state. There are only ten such "grandfathered" institutions in the United States. Hearing before the House Subcommittee on Financial Institutions in H.R. 3864 p. 163 (96th Cong., 1st Sess. May 15-17, June 12-14, 1979, Serial No. 96-31). Recently, the Board approved a multistate purchase of associations by a federal association. Los Angeles Times, Pt. IV p. 1, Sept. 9, 1981.

[3] That the Federal Home Loan Mortgage Corporation may require lenders who sell instruments to them to use a deed of trust with a due-on-sale clause is irrelevant because California law does not preclude a due-on-sale clause—only its enforcement in certain instances.

When the association or the trustee decides to foreclose by virtue of the enforcement of a due-on-sale clause, it takes advantage of California's non-judicial or judicial foreclsoure laws. *See, e.g.,* Cal. Civ. Code § 2924. In fact, these foreclosure provisions provide that there cannot be foreclosures based on the enforcement of due-on-sale clauses in certain instances. Cal. Civ. Code § 2924.5. California law governs the rights of the parties to the note and the deed of trust. Cal. Civ. Code § 755.

Until July 31, 1976, no regulation of the Federal Home Loan Bank Board authorized the exercise of due-on-sale clauses, or for that matter, placed any limitations on their use. Instead, federal associations routinely resorted to state laws to litigate the enforceability of such clauses against their borrowers. *See infra* at n. 8. In 1976, some 44 years after its creation, the Board suddenly concluded it had the authority to preempt state law dealing with borrowers' rights.

(ii) CONGRESS DID NOT INTEND THAT THERE BE PREEMPTION.

There is not one word in the HOLA, which is the federal statute dealing with federal associations, suggesting preemption, and there is no legislative history indicating such preemption.

The legislative history of HOLA reveals only one purpose for the creation of federally chartered savings and loan associations—to create mortgage lenders in areas where none then existed.[4] Thus the purpose of the federally chartered savings and loans had nothing to do with state regulations or state practices.

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[4] See Report of the House Committee on Banking and Currency (H.R. Rept. No. 55) 73d Cong. 1st Sess., p. 2 (April 25, 1933) (hereinafter "House Committee Rept."); Report of the Senate Committee on Banking Currency (Sen. Rept. No. 91) 73d Cong. 1st Sess. pp. 2-3 May 15, 1933); Hearings on HOLA Act H.R. 4980, H.R. Comm. on Banking and Currency, April 21, 1933, pp. 14-15 "The bill also provides for the board to charter Federal savings and loan associations in communities now insufficiently served by any institution or other lender on homes, so that provision may be made for the financing of homes in more than 1,500 counties in the United States now having no such facilities." House Committee Rept., p. 2.

That the Board may have exclusive authority with respect to some activities of the federal associations does not mean it has exclusive authority over all areas of regulation touching upon these institutions (e.g., crimes, real property transactions, zoning, consumer protection and contractual relations with third parties). As the Supreme Court stated in *Kelly v. Washington,* 302 U.S. 1, 10 (1937):

> "There is no constitutional rule which compels Congress to occupy the whole field. Congress may circumscribe its regulation and occupy only a limited field. When it does so, state regulation outside that limited field and otherwise admissible is not forbidden or displaced. . . ."

Nothing in HOLA addresses any aspect of the enforceability of federal associations' contracts with third parties. Presumably, if Congress had intended to preempt state contract law, it would have expressly so stated or, at a minimum, addressed the subject of contract law in HOLA. It did neither.

Even assuming Congress had established a pervasive regulatory scheme, that would not result in preemption.

> "We reject, to begin with, the contention that preemption is to be inferred merely from the comprehensive character of the federal . . . [legislative scheme]. The subjects of modern social and regulatory legislation often by their very nature require intricate and complex responses from the Congress, but without Congress necessarily intending its enactment as the exclusive means of meeting the problem. . . ." *New York State Dept. of Social Services v. Dublino,* 413 U.S. 405, 415 (1973) (Citations omitted.)

See Note, *The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court,* 75 Colum. L. Rev. 623, 654 (1975). *Confederated Tribes, etc. v. State of Wash.,* 519 F.2d 89, 91 (9th Cir. 1979). ("It will not be presumed that a federal statute was intended to supersede the exercise of the power of the state unless there is a clear manifestation of intention to do so. The exercise of federal supremacy is not lightly to be presumed.")

The contemporaneous administrative practice at the time the HOLA was enacted also suggests that Congress did not intend to confer upon the Board the right to preempt state law in the areas in question. The Board was active in chartering savings and loans (T. Marvell, *The Federal Home Loan Bank Board* 115 (1969)), but it was relatively inactive in promulgating regulations. *Id.* at 150. Indeed, the Board did not enact a comprehensive set of regulations. That is why even as to matters involving internal affairs of federal associations, state laws were applied for years, and without any assertion of preemption.[5]

Interestingly, it was not until 1948 that a regulation purported to deal with contracts with third persons, and that was a general provision on loan contracts.[6] It was not until June of 1976, after litigation with the State of California was commenced, that the Board specifically dealt with due-on-sale clauses in regulations.

Moreover, for decades courts have applied state law in determining the contractual rights of federal associations *vis-a-vis* borrowers. Since there is no federal recording statute, federal associations recorded their security instruments with the states, and their rights under these instruments have been determined under state lien priority rules.[7] The loans of

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[5] *See Pearson v. First Federal S. & L. Ass'n*, 149 So.2d 891, 894-896 (Ct. App. Fla. 1963) (validity of proxies); *Ochs v. Washington Heights Fed. S. & L. Ass'n*, 268 N.Y.S.2d 274 (1966) (right to inspect membership list); *In re Election of Directors of Baldinsville Federal S. & L. Ass'n*, 51 N.Y.S.2d 816 (App. Div. 1944) (election of directors).

[6] See 12 C.F.R. 545.6-11 as adopted in 23 Fed. Reg. 9902, December 23, 1958. With slight language changes, the regulation is now contained at 12 C.F.R. 545.8-3(a).

[7] *E.g., First Fed. S. & L. Ass'n v. Ott*, 285 So.2d 5 (Fla. App. 1973), *cert. denied*, 291 So.2d 10 (1974) (constructive notice); *Anatole Caron, Inc. v. Manchester Fed. S. & L.*, 10 A.26 668 (N.H. 1940) (mechanic's lien law); First Fed. S. & L. Ass'n v. Green-Acres Building Corp., 236 N.Y.S.2d 1009 (Cty. Ct. 1963) (priority of lien under future advances clause); *Apex Siding & Roofing Co. v. First Fed. S. & L. Ass'n of Shawnee*, 301 P.2d 352 (Okla. 1956) (equitable estoppel to assert priority).

federal associations have always been enforced in state courts pursuant to state laws.[8] And the rights of federally chartered savings and loans have always been deemed to be limited by state-created rights of borrowers such as the rights of redemption, antideficiency laws and other equitable defenses.[9]

State law has routinely been applied to all types of contractual disputes between borrowers and federal associations,[10] and in some instances the application of state law has resulted in the invalidity or unenforceability of those contracts.[11]

In light of the forty year history of application of state law to federal savings and loan contracts with borrowers and the lack of Board regulation in the area, it is inconceivable that Congress had intended preemption.

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[8] *E.g., Kanakee Fed. S. & L. Ass'n v. Arnove,* 47 N.E.2d 874 (Ct. App. Ill. 1943); *Minnesota Fed. S. & L. v. Central Enterprises of Superior, Inc.,* 247 N.W.2d 46 (Minn. 1976); *Home Fed. S. & L. v. Four Star Heights, Inc.,* 333 N.Y.S.2d 334 (Sup. Ct. 1971); *Benjamin Franklin Fed S. & L. Ass'n v. Almond,* 577 P.2d 937 (Or. 1978).

[9] *E.g., In re Wilton-Maxfield Mgt. Co.,* 117 F.2d 913 (9th Cir. 1941) (anti-deficiency statute). *Caudle v. First Fed. S. & L. of Sylacauga,* 327 So.2d 911 (Ala. 1976) (statutory right of redemption); *Hartford Fed. S. & L. Ass'n v. Lenczyk,* 21 A.2d 694 (Conn. 1966) (anti-deficiency law); *Tahoe Highlander v. Westside Fed. S. & L.,* 588 P.2d 1022 (Sup. Ct. Nev. 1979) (anti-deficiency law); *Penn Fed. S. & L. Ass'n v. Joyce,* 183 A.2d 114 (N.J. App. Div. 1962) (statutory and equitable rights of redemption).

[10] *E.g., First Nat'l State Bank of N.J. v. Commonwealth Fed. S. & L.,* 455 F. Supp. 464 (D.N.J. 1978, *aff'd* 610 F.2d 164 (3d Cir. 1979); *Hawkins v. First Fed. S. & L. Ass'n,* 280 So.2d 93 (Ala. 1973); *Martyn v. First Fed. S. & L. of West Palm Beach,* 257 So.2d 576 (Ct. App. Fla. 1971) *cert. denied,* 262 So.2d 446 (192); *Townsend v. First Fed. S. & L. Ass'n,* 15 So.2d 199 (Fla. 1943); *First Fed. S. & L. Ass'n of Bowling Green v. Savage,* 435 S.W.2d 67 (Ct. App. Ky. 1968); *Parkway Inn, Inc. v. First Fed. S. & L. of Rochester,* 269 N.Y.S.2d 730 (Sup. Ct. 1966), *aff'd* 279 N.Y.S.2d 1021 (1967); *Railroad Fed. S. & L. Ass'n v. Carr,* 41 N.Y.S.2d 262 (App. Div. 1943); *Fed. S. & L. of Oklahoma v. Baxter,* 91 P.2d 760 (Okla. 1939).

[11] *E.g., Patton v. First Fed S. & L. Ass'n of Phoenix,* 578 P.2d 152 (Ariz. 1978); *Tucker v. Pulaski Fed S. & L. Ass'n,* 485 S.W.2d 725 (Ark. 1972); *First Fed. S. & L. Ass'n of Boston v. LeClair,* 253, A.2d 46 (N.H. 1969); *Continental Fed. S. & L. Ass'n v. Fedder,* 564 P.2d 1013 Okla. 1977); *Bellingham First Fed. S. & L. Ass'n v. Garrison,* 553 P.2d 1090 (Wash. 1976).

(iii) THERE IS NO CONFLICT BETWEEN FEDERAL AND STATE LAW.

The Board regulation (12 C.F.R. § 545.8-3(f) and (g)) itself does not conflict with state law. It does not require any association to accelerate a loan. Rather, it merely restricts the exercise of the clause in certain limited circumstances, but otherwise makes the acceleration of loans a matter of contract between the borrower and lender. California law, on the other hand, protects borrowers by providing them with state law defenses against arbitrary and capricious accelerations by lenders. *See e.g.*, Cal. Civ. Code § 2924.6; *Wellenkamp v. Bank of America*, 21 Cal.3d 943 (1978); *Tucker v. Lassen Sav. & Loan Assn.*, 12 Cal.3d 629 (1974). Thus, the two regulatory schemes are not only not in conflict, but the state law actually enhances the operation of the federal scheme by encouraging home ownership and discouraging unjustified foreclosures. This was the purpose of Congress in enacting HOLA. *See* 12 U.S.C. § 1464(a). The decision to enforce due-on-sale clauses is that of the federal association not of the Board.[12] Federal authorization clearly does not result in immunity of private entities from state law.[13]

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[12] See *Greater Westchester Homeowners Ass'n v. City of Los Angeles*, 26 Cal.3d 86 (1979) (held airport proprietor liable in nuisance action for acts taken with the permission (and even "federal advice, approval and even encouragement") of the Federal Aviation Administration).

[13] *McClellan v. Chipman*, 614 U.S. 347, 356-57 (1896) (state law precluding banks from taking real property as security for preexisting debt valid as applied to a National Bank even though National Bank Act expressly authorized such a taking); *Florida Lime & Avocado Growers v. Paul*, 373 U.S. 132, 142-43 (1963) (Varying state and federal maturity standards for fruit resulted in state prohibition of fruit as immature, which fruit was federally certified as mature. The Court noted no "impossibility of dual compliance" because the growers could have complied with both standards by changing their harvesting methods.); *Huron Portland Cement Co. v. City of Detroit*, 362 U.S. 440, 446-68 (1960) (Federally licensed vessel is subject to nondiscriminatory state laws); *Kargman v. Sullivan*, 552 F.2d 2, 6-13 (1st Cir. 1977), *reh. denied* 558 F.2d 612 (1977) and later app. 582 F.2d 11 (1978) (Federal permission to raise rents does not justify violation of rent control law where federal action was permissive, not mandatory); *Hughes v. Trans. World Airlines, Inc.*, 336 A.2d 572, 578-579 (Del.), *cert. denied*, 423 U.S. 841 (1975) and on remand 374 A.2d 5 (Del. Ch. 1977); *State ex. rel. Andrus v. Click*, 554 P.2d 969 (Idaho 1976); *Marshall v. Consumers Power Co.*, 237 N.W.2d 26, 280-281 (Mich. 1976).

Therefore, Board authorization of a due-on-sale clause does not suggest a conflict between state and federal law. Indeed, courts should not seek out conflicts where none clearly exists. *Huron Portland Cement Co. v. City of Detroit,* 362 U.S. 440, 446 (1960).

The regulation's provisions that the rights of borrowers are to be governed by the "terms of the contract" between the borrowers and the association, could not mean that contractual terms which are illegal under state law are nonetheless enforceable. Where, as here, the federal and state regulatory schemes can be read consistently, the United States Supreme Court has stated that "the proper approach is to reconcile the operation of both statutory schemes with one another rather than holding one completely ousted." *Merrill, Lynch, Pierce, Fenner & Smith v. Ware,* 414 U.S. 117, 127 (1973).

Of course expressions by the Board of preemptive intent (e.g. 12 C.F.R. § 556.9(f) promulgated after the decision in the instant case) does not result in a substantive rule requiring preemption. *See Chrysler Corp. v. Brown,* 441 U.S. 281, 302 (1979).

Even a Board attempt to preempt would not be valid. It is "the intent of Congress" that determines whether there is preemption. *Malone v. White Motor Corp.,* 435 U.S. 497 (1978). Professor John Hetland has referred to the Board's efforts to preempt by regulation as "a doubtful premise in view of the scope of preemption permissible under the powers delegated to it by Congress." J. Hetland, *Secured Real Property Transactions* (Cont. Ed. Bar 1977) p. 32; see Hirsh, *Towards a New View of Federal Preemption,* 1972 Univ. of Ill. L. Forum 515, 551. ("Only rarely does the [Supreme] Court respect clear expressions of agency intent to supersede or to preserve state laws.")

Moreover, by what authority does the Board purport to grant to private parties the right to abrogate state-created rights? An agency cannot delegate such responsiblities to regulatees.[14] HOLA cannot be interpreted to relieve a regulated party of liability to a third party.[15] *See also First Federal Savings and Loan Association of Englewood v. Lockwood,* 385 So. 2d 156 (Ct. App. Fla. 1980) (federal regualtions do not and cannot preempt traditional state equitable considerations which require a judicial inquiry as to whether the security was impaired by the sale in breach of the due-on-sale clause). Finally, the Board cannot eliminate property rights of state citizens. *See Board of Regents v. Roth,* 408 U.S. 564, 577 (1972).

The federal associations even claim that state law is inapplicable to loans made before the Board regulations were enacted. There is no federal law or regulation which even arguably conflicts with state law as to preregulation loans.

The 1976 regulations should not be construed as being retroactively applicable to preregulation loans. To apply such a regulation retroactively would involve unconstitutional action in that it would take certain accrued rights away from borrowers. *Home Bldg. & Loan Ass'n v. Blaisdell,* 290 U.S. 398 (1934).

(iv) THE PREEMPTION DOCTRINE IS INAPPLICABLE IN THIS CASE.

State law may be prempted by Federal legislation only where Congress either intended preemption, or where there is a conflict between federal law and state law (*Ray v. Atlantic Richfield Co.,* 435 U.S. 151, 157-158 (1978)) such as "where compliance with both federal and state regulations is a physical

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[14] *See National Association of Independent Television Producers and Distributors v. F.C.C.,* 516 F.2d 526 (2d Cir. 1975).

[15] *See Regents of the University System of Georgia v. Carroll,* 338 U.S. 586, 602 (1950) ("We do not read the Communications Act to give authority to the Commission to determine the validity of contracts between licensees and others."); *Nader v. Allegheny Airlines, Inc.,* 426 U.S. 290 (976) (action can be maintained despite fact that act was authorized by the C.A.B.).

impossibility". *Florida Avocado Growers v. Paul,* 373 U.S. 132, 142-143 (1963). This court should be mindful of its repeated warnings that preemption is "not lightly to be presumed." *Schwartz v. Texas,* 344 U.S. 199, 202-203 (1952), cited with approval in *New York Dept. of Social Services v. Dublino,* 413 U.S. 405, 414 (1973). *Accord, Exxon Corp. v. Governor of Maryland,* 437 U.S. 117, 132 (1978). ("This Court is generally reluctant to infer preemption.")

There are sound policy reasons for such narrow application. If no preemption is found, Congress can always change the results by legislation; erroneous preemption, however, leaves the states impotent to correct the situation. *See City of Burbank v. Lockheed Air Terminal* 411 U.S. 624, 643 (1973) (dissenting opinion).

As noted above, there is no conflict between state and federal law. There is no express preemption. And the legislative history of HOLA suggests that preemption cannot be inferred.

In the instant case no uniformity is needed since the federal associations generally operate only in their home states and federal and state laws do not even purport to regulate the same subject. Federal law regulates the operation of federally-chartered savings and loan associations while state law regulates real property transactions.

No case holds that federal law occupies the fields of contract law and real estate law simply because one party to a transaction happens to be a federally chartered savings and loan association. Indeed, the cases are to the contrary.[16] An occupation of the field theory of preemption would mean that all notes and mortgages to which a federal savings and loan is a party would have to be governed by federal common law.[17]

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[16] See *Derenco Inc. v. Benjamin Franklin Fed. S. & L. Ass'n,* 281 Or. 533, 577 P.2d 477 (1978), *cert. denied* 439 U.S. 1051 (1978); *De Simone v. Warwick Fed. S. & L. Ass'n,* 482 F. Supp. 1190 (D.R.I. 1980).

[17] See *Textile Workers Union v. Lincoln Mills of Alabama,* 353 U.S. 448, 456-457 (1967); Osborne, Nelson and Whitman, *Real Estate Finance Law* 694-695 (1979).

Showing the impact of state law on these private institutions which are "regulated" by a federal agency does not show interference with federal regulation. A federally chartered savings and loan association is "an essentially private business organization. . . It is wholly private in character; it is not part of the Federal government and performs no substantial Federal function."[18] Moreover, even if the federal savings and loans were "federal instrumentalities" they would be "subject to the laws of the state . . . all their contracts are governed and construed by state laws", and state law is only inapplicable when it "incapacitates [them] from discharging their duties to the government . . ."[19]

The existence of comprehensive federal regulation, which may be different than state regulation, does not in itself result in preemption.[20]

There is no authority to suggest that Congress gave the Board power to override historic state laws concerning real property transactions with local residents. Indeed, "before preemption shall be deemed to have occurred there must be either a clear manifestation of such congressional intent or a conflicting inconsistency between state and federal regulations . . . . The is particularly true where the field of regulation is one that has been traditionally occupied by the states."[21] *See*

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[18] *Midwest Federal S. & L. Ass'n v. Commissioner of Revene*, 259 N.W.2d 596, 598 (Minn. 1977). The associations are not federal instrumentalities with regard to their loan functions. *Gibson v. First Federal Savings & Loan Ass'n*, 347 F. Supp. 560, 563 (E.D. Mich. 1972). Indeed, state associations and other financial institutions regulated at least in part by the federal government may be similarly affected by state law.

[19] *McClellan v. Chipman*, 164 U.S. 347, 356-57, 359 (1896). *See also Anderson Nat'l Bank v. Luckett*, 321 U.S. 233, 247-48 (1944); *First National Bank of Louisville v. Commonwealth of Kentucky*, 76 U.S. (9 Wall) 353, 362 (1870).

[20] *New York Dept. of Social Services v. Dublino*, 413 U.S. 405, 415 (1973); *Head v. New Mexico Board of Examiners*, 374 U.S. 424 (1963).

[21] *Katharine Gibbs Sch. (Inc.) v. F.T.C.*, 612 F.2d 658, 667 (2d Cir. 1979) (held regulation beyond Commission's power); *Civil Aeronautics Bd. v. Delta Air Lines, Inc.*, 367 U.S. 316, 322 (1961) ("[T]he board is entirely a creature of Congress and the determinative question is not what the Board thinks it should do but what Congress has said it can do.")

United States v. Little Lake Misere Land Co., 412 U.S. 580, 591-522 (1973); *Butner v. United States*, 440 U.S. 48 (1979); *Hoopeston Canning Co. v. Cullen*, 318 U.S. 313 (1942) (state law is the "source of law . . . for mortgages, and for many other legal principles affecting property interests"); *Sunderland v. United States*, 266 U.S. 226, 232 (1924); *United States v. Fox*, 94 U.S. 315, 320 (1877) (transfer of property a state matter).

(v) EVEN IF THE BOARD REGULATION CAN BE CONSTRUED LEGALLY TO PREEMPT STATE LAW, BY AGREEING TO USE STATE LAW THE FEDERAL ASSOCIATIONS HAVE WAIVED ANY PREEMPTION RIGHTS.

As noted above, the federal association uses notes and deeds of trust which specifically provide for the application of state law. It uses California corporations as trustees which actually enforce the due-on-sale clauses.

By obtaining an interest in California real estate, the federal association has agreed to be bound by state law. Cal. Civ. Code § 755. Indeed, its own deed of trust demonstrates that it not only utilizes state law to enforce its mortgage interests, but also, in effect, has agreed to be bound by state law.

In *United States v. Stewart*, 523 F.2d 1070 (9th Cir. 1975), the court held that the government was bound by state law relating to deficiency judgments in connection with a Veteran's Administration loan when the note and the deed of trust provided for the application of state law. Similarly, in *United States v. MacKenzie*, 510 F.2d 39 (9th Cir. 1975), the court in an *en banc* decision held that state anti-deficiency law applied to SBA loans. The court noted that as in *United States v. Yazell*, 382 U.S. 341 (1966), "by thwarting debtor protections imposed by state law, the Government obtained an unconscionable advantage over debtors by gaining rights that no other creditor could have had." 510 F.2d at 41. Here, the federal associations seek rights against their borrowers which state associations do not have. The fact that its own loan

instruments call for the application of California law makes its position even more unconscionable. Under the law, it is thus clear that the federal association consented to be bound by California law.

In their dealings with California property, the federal savings and loan associations are subject to California law, which provides that "Real Property within this State is governed by the law of this State, except where the title is in the United States." Cal. Civ. Code § 755. *See United States v. Certain Parcels of Land,* 131 F. Supp. 65, 70 (S.D. Cal. 1955). By claiming immunity from California law against unreasonable restaints on alienation, while at the same time taking advantage of other California laws, the federal institutions are in effect asserting the right to pick and choose those parts of the California law which they will allow to be applied.

The federal associations must not be permitted to avail themselves of the benefits of the California law of mortgages, while simultaneously refusing to be bound by those portions of that same law which they find distasteful.

As the Supreme Court stated in upholding the applicability of a state statute to banks, "It is a strange argument that permits one to pick and choose what portion of the law binds him." *First Nat. Bank. v. Walker Bank,* 385 U.S. 252, 261 (1966); *see also First Citizens Bank and Trust Company v. Camp,* 409 F.2d 1086, 1091 (4th Cir. 1969), *aff'g* 181 F. Supp. 786 (E.D.N.C. 1968).

Thus, even if there were some preemption (which there is not), the federal associations have, by their activities, waived the right to assert it.

(vi) THERE ARE REASONS WHY THIS COURT SHOULD NOT NOTE PROBABLE JURISDICTION.

California appellate courts have held that there is no preemption as to the application of state law to the substantive

rights of borrowers from federally chartered associations.[22] *Panko v. Pan American Fed. Sav. & Loan Assn.*, 119 Cal. App. 3d 916, 174 Cal. Rptr. 240 (1981); *de la Cuesta v. Fidelity Federal Savings and Loan Assn.*, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981). In these cases, the California Supreme Court has not granted a hearing, thus making the law of the instant case the law of California. *See also* Note, *Due-on-Sale Clause and Restraints on Alienation: Does Wellenkamp Apply To Federal Institutions?* 11 Pac L. Jour. 1085 (1980).

That certain federal courts have held that there was preemption is irrelevant since federal courts generally have no jusisdiction to hear cases between the association and the borrower. *See Guinasso v. Pacific First Federal Savings and Loan Ass'n.*, 656 F.2d 1364 (9th Cir. 1981); *Washington v. American League of Professional Baseball Clubs*, 460 F.2d 654, 660 (9th Cir. 1972); *First Nat. Bank of Aberdeen v. Aberdeen Nat. Bank*, 627 F.2d 343, 350-353 (8th Cir. 1980); *People v. Glendale*, 475 F. Supp. 728 (C.D.Cal 1979).

There is presently pending in Congress legislation dealing with this subject matter which may render this and other cases in large part moot. S. 1703, 97th Cong. 1st Sess. Oct. 5, 1981. Moreover, the federal associations have been provided with various new devices which offset any difficulties encountered with enforcing the due on sale clause. *See e.g.* 12 C.F.R § 545.6-4(c) (allows variable interest rate loans); 46 Fed. Reg. 24148 (adjustable interest rate provisions); 46 Fed. Reg. 32013 (decreases liquidity requirement); Econ. Recovery Act of 1981, Section 301, 97 Stat __ (allows tax free accounts).

Moreover, in order to find preemption, there must be some factual showing of conflict in the operation of federal and state law. *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978); *Jones*

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[22] *Compare Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.* 445 U.S. 921 (1980) (held that certain procedural aspects of California's anti-redlining law were preempted, but left open the question as to whether the substantive rights of citizens under state law were preempted; we deal here with the substantive rights of borrowers under state laws).

v. Rath Packing Co., 430 U.S. 519, 526 (1977); *De Canas v. Bica*, 224 U.S. 351 (1976); *Askew v. American Waterways, Inc.*, 411 U.S. 325 (1973). The instant case arises by way of a summary judgment. Accordingly, these cases are inappropriate vehicles for resolution of the issues involved.

B. CONCLUSION

For all of the foregoing reasons, *Amicus* urges the court to either affirm the judgment without a hearing or to dismiss the appeal.

Respectfully submitted,

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No. 81-750

In the Supreme Court of the United States

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL., APPELLANTS

v.

REGINALD D. DE LA CUESTA, ET AL.

ON APPEAL FROM THE CALIFORNIA COURT OF APPEAL FOR THE FOURTH APPELLATE DISTRICT

BRIEF FOR FEDERAL HOME LOAN BANK BOARD AS AMICUS CURIAE

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QUESTION PRESENTED

Whether a California statute prohibiting "restraints on alienation" of property, as applied to a "due on sale" clause in a mortgage written by a federal savings and loan association, has been preempted by the Home Owners' Loan Act of 1933, 12 U.S.C. (& Supp. III) 1461 *et seq.*, as implemented through regulations of the Federal Home Loan Bank Board.

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In the Supreme Court of the United States

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No. 81-750

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL., APPELLANTS

v.

REGINALD D. DE LA CUESTA, ET AL.

ON APPEAL FROM THE CALIFORNIA COURT OF APPEAL FOR THE FOURTH APPELLATE DISTRICT

BRIEF FOR FEDERAL HOME LOAN BANK BOARD AS AMICUS CURIAE

INTEREST OF THE FEDERAL HOME LOAN BANK BOARD

The Federal Home Loan Bank Board is an independent federal regulatory agency created in 1932 and invested with authority to administer the Home Owners' Loan Act of 1933, 12 U.S.C. (& Supp. III) 1461 *et seq.* ("the Act"). Under the Act, "the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations' * * *." 12 U.S.C. (& Supp. III) 1464(a). Pursuant to this mandate, the Board has promulgated regulations governing virtually every aspect of a federal savings and loan association "from its cradle to its corporate grave." *California* v. *Coast Federal Savings & Loan Association*, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

In 1976 the Board adopted the following regulatory provision, which governs due-on-sale clauses in mortgages:

> A Federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent.

41 Fed. Reg. 18288 (1976), codified at 12 C.F.R. 545.8-3(f). It has been the Board's consistent position that the validity of due-on-sale clauses is a question of national importance that must be decided in accordance with the Board's regulations rather than conflicting state laws. See Federal Home Loan Bank Board, Resolution No. 75-647 (July 30, 1975); 41 Fed. Reg. 18287 (1976). Accordingly, the Board has a direct interest in urging this Court to note probable jurisdiction to review the decision of the Court of Appeal, which significantly narrowed the scope of the Board's authority in this area.

STATEMENT

Appellants are a federal savings and loan association chartered by the Board pursuant to Section 5(a) of the Act, 12 U.S.C. (& Supp. III) 1464(a) (J.S. 3) and its wholly-owned subsidiary. Appellees purchased separate parcels of real property, each of which served as security under a deed of trust for loans made by appellants to persons who sold the property (J.S. App. 5a, 21a, 22a-23a). The deeds of trust all included a provision, commonly known as a due-on-sale clause, permitting appellants to declare the entire balance of the loan due if the property securing it is transferred without the prior written consent of the appellants (*ibid.*). Appellants exercised their option to declare the balance due.

When the balance was not paid, appellants instituted non-judicial foreclosure proceedings.[1]

Appellees then filed the instant suit in the Superior Court of California for the County of Orange, seeking to enjoin the foreclosure proceedings (J.S. App. 3a). Appellees asserted that enforcement of the due-on-sale clause violated Cal. Civ. Code § 711 (West 1954), which forbids restraints on the alienation of real property. The court granted appellants' motion for summary judgment. It concluded that the state statute was preempted by the Home Owners' Loan Act of 1933, as administered by the Board through regulations that permit enforcement of due-on-sale clauses in deeds of trust (J.S. App. 29a-31a).

On appeal, the Court of Appeal for the Fourth Appellate District reversed (J.S. App. 1a-26a). The court adopted in large measure an opinion by the Court of Appeal for the First Appellate District in *Panko* v. *Pan American Federal Savings & Loan Association*, 119 Cal. App. 3d 916, 174 Cal. Rptr. 240 (1981) (J.S..App. 4a-5a).[2] The Court of Appeal

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[1] Appellants were willing to consent to the transfer of the property if appellees were willing to have the interest rates on the promissory notes increased to the prevailing market rates at that time (J.S. 4).

[2] We are advised that the defendants in *Panko* plan to file an appeal to this Court from the state court's judgment in that case. No jurisdictional statement has yet been filed.

In addition, there have been two subsequent decisions by the Fourth Appellate District that also have declared the state statute to be controlling. *Gross* v. *Glendale Federal Savings & Loan Association*, No. 21903 (4th Dist. July 23, 1981); *Hehir* v. *Glendale Federal Savings & Loan Association*, No. 23309 (4th Dist. July 2, 1981). Counsel for the savings and loan associations in those cases also have informed us that it is their intention to file an appeal from those decisions. There also has been a decision by the Second Appellate District holding the state statute to be preempted by the Board's regulation, thus creating a conflict within the State. See *California* v. *Glendale Federal Savings & Loan Association*, No. 60306 (2d Dist. Aug. 21, 1981) (opinion decertified for publication by the California Supreme Court under Cal. Const. Art. VI, § 14; Rule 976, Cal. Ct. R.).

held that the due-on-sale clause clearly violated California's statute prohibiting restraints on alienation of real property, as interpreted by the California Supreme Court in *Wellenkamp* v. *Bank of America*, 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978) (J.S. App. 3a-4a). It also held that the statute was not preempted by the Board's regulation because the two provisions were not necessarily incompatible (J.S. App. 17a). The court pointed to the fact that the Board's regulation did not mandate the presence of a due-on-sale clause in every mortgage and concluded that nonenforceability of the clause would not impair any regulatory purpose. For the same reason, the court rejected the contention that there was a need for a uniform rule regarding the loan practices in question (J.S. App. 18a-19a). Finally, the court found "support" for its preemption analysis in a covenant in the deed of trust which provided that the deed would "be governed by the law of the jurisdiction in which the Property is located" (J.S. App. 19a-20a).

The California Supreme Court denied appellants' petition for hearing (J.S. App. 28a).

DISCUSSION

The decision of the California Court of Appeal conflicts in both its reasoning and its holding with numerous federal and state court decisions. If allowed to stand, it will seriously impair the federal government's efforts to control federal savings and loan associations' mortgage rates. Plenary review of the decision of the Court of Appeal therefore is warranted.[3]

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[3]The Board agrees with appellants (J.S. 2 & n.2) that this case properly is before this Court on appeal under 28 U.S.C. 1257(2). Appellants expressly raised the constitutional validity of Section 711 of the Cal. Civ. Code (West 1954) as applied to this case. The Court of Appeal upheld the state provision as consistent with federal law and sustained its constitutionality. This case is indistinguishable from *Reconstruction Finance Corp.* v. *Beaver County*, 328 U.S. 204, 206-207 (1946), and *First National Bank of Guthrie Center* v. *Anderson*, 269 U.S. 341, 344 (1926), in which this Court exercised appellate jurisdiction.

1. The decision of the Court of Appeal conflicts in principle with decisions of other appellate courts. The court apparently was of the view that the scope of the Board's authority is limited to regulating the "internal affairs" of savings and loan associations (J.S. App. 16a). This view of the Board's power stands in stark contrast to prior decisions holding that Congress intended to grant the Board pervasive regulatory control over these associations. See, *e.g.*, *Conference of Federal Savings & Loan Associations* v. *Stein*, 604 F. 2d 1256, 1257 (9th Cir. 1979), aff'd, 445 U.S. 921 (1980) (reporting and notice requirements regarding possible discriminatory lending practices); *First Federal Savings & Loan Association of Boston* v. *Greenwald*, 591 F. 2d 417, 425 (1st Cir. 1979) (payment of interest on escrow accounts); *Kupiec* v. *Republic Federal Savings & Loan Association*, 512 F. 2d 147, 150 (7th Cir. 1975) (methods of supplying notice to association members); *Kaski* v. *First Federal Savings & Loan Association of Madison*, 72 Wis.2d 132, 135, 240 N.W.2d 367, 370 (Wis. 1976) (prepayment penalties). But see *Gulf Federal Savings & Loan Association of Jefferson Parish* v. *Federal Home Loan Bank Board*, 651 F. 2d 259, 266 (5th Cir. 1981) (Board's power limited to controlling internal affairs of federal associations).

Several of these cases clearly affirm the Board's power to regulate the external affairs of thrift institutions. Thus, the Wisconsin Supreme Court has held that federal law alone controls the validity of a variable rate mortgage. *Kaski* v. *First Federal Savings & Loan Association of Madison*, *supra*, 72 Wis.2d at 133, 240 N.W.2d at 369. Similarly, the Ninth Circuit has held that the validity of a prepayment penalty in a mortgage of a federal association is determined solely by Board regulation, and not state law. *Meyers* v. *Beverly Hills Federal Savings & Loan Association*, 499 F. 2d 1145, 1147 (9th Cir. 1974). Finally, the First Circuit

has held that the duty of a federal savings and loan association to pay interest on mortgage escrow accounts is a matter regulated by the Board and that contrary state law is preempted. *First Federal Savings & Loan Association of Boston* v. *Greenwald, supra,* 591 F. 2d at 425. These decisions, which broadly construe the Board's authority to regulate mortgage provisions, and which strike down inconsistent standards under state law, cannot be reconciled with the ruling of the Court of Appeal in this case.[4]

These decisions also contradict the Court of Appeal's holding that the Board's failure to require due-on-sale clauses in all mortgages indicates that there is no uniform, national policy served by the Board's regulations. In none of these cases did the Board require that a particular provision be included in all mortgages, yet in each case the courts gave controlling effect to the federal standard.[5]

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[4]A second apparent rationale for the Court of Appeal's decision that state law controls in this case is that a federal administrative agency was the source of federal law. The court reasoned that the decision to oust state law "is a fundamental one going to the very fabric of federalism; thus, the decision is one to be made by the people through their elected representatives in Congress rather than by agencies * * *" (J.S. App. 15a). This Court has long recognized, however, that an administrative regulation which properly implements a congressional statute has the identical preemptive effect of the statute itself. *Free* v. *Bland,* 369 U.S. 663, 668 (1962); *United States* v. *Shimer,* 367 U.S. 374, 385 (1961).

[5]The Court of Appeal's analysis of the Board's use of precatory language ignores the practical considerations underlying these clauses. The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association require a due-on-sale provision to be included in any mortgage they purchase (see note 8, *infra*). Since the ability to sell a mortgage is important to a savings and loan association, very few mortgages are written without this provision. In light of this and the fact that the Board could not as a practical matter require the association to enforce such a clause even if the Board required it to be included in a mortgage, the Board had no reason to make these provisions mandatory. It was sufficient for the Board's regulatory purposes to make clear that due-on-sale clauses are *permissible* and *enforceable* as a matter of federal law.

Indeed, we believe that the Board's authority to act is so clear and that the exercise of that authority to preempt state law is so plain[6] that we would be inclined to recommend summary reversal of the decision of the Court of Appeal but for the fact that there is some judicial authority that supports its decision. Two other state courts have declared due-on-sale clauses to be unenforceable, notwithstanding the Board's contrary regulation. See *Holiday Acres No. 3* v. *Midwest Federal Savings & Loan Association of Minneapolis*, 308 N.W.2d 471 (Minn. 1981); *First Federal Savings & Loan Association of Englewood* v. *Lockwood*, 385 So.2d 156 (Fla. Dist. Ct. App. 1980).[7] And at least one

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[6]When the Board announced its regulation in 1976, it explained its purpose with unmistakable clarity: "Finally, it was and is the Board's intent to have * * * due-on-sale practices of Federal associations governed exclusively by Federal law." 41 Fed. Reg. 18287 (1976).

[7]We note, however, that there have been many district court decisions declaring state laws restricting the right of federal associations to use due-on-sale clauses unconstitutional under the Supremacy Clause (Article VI, Section 2). See, *e.g.*, *Glendale Federal Savings & Loan Association* v. *Fox*, 481 F. Supp. 616 (C.D. Cal. 1979), rev'd on other grounds, No. 79-3573 (9th Cir. Sept. 25, 1981); *Conference of Federal Savings & Loan Associations* v. *Stein*, 495 F. Supp. 12 (E.D. Cal. 1979), rev'd on other grounds, No. 79-4818 (9th Cir. Sept. 23, 1981); *Bailey* v. *First Federal Savings & Loan Association of Ottawa*, 467 F. Supp. 1139 (C.D. Ill. 1979); *Nalore* v. *San Diego Federal Savings & Loan Association*, No. 77-0660-N (S.D. Cal. July 12, 1979), rev'd on other grounds, No. 79-3481 (9th Cir. Sept. 23, 1981); *Williams* v. *First Federal Savings & Loan Association of Arlington*, 500 F. Supp. 307 (E.D. Va. 1980), aff'd on other grounds, 651 F. 2d 910 (4th Cir. 1981); *Great Western Union Federal Savings & Loan Association* v. *Walters*, No. C79-906V (W.D. Wash. June 18, 1980); *Trent Realty Association* v. *First Federal Savings & Loan Association of Philadelphia*, No. 79-1688 (D. N.J. Sept. 16, 1980), rev'd on other grounds, 657 F. 2d 29 (3d Cir. 1981); *Collins* v. *First Federal Savings & Loan Association of Walla Walla*, No. C-80-334 (E.D. Wash. May 18, 1981); *First Federal Savings & Loan Association o, Gadsden County* v. *Peterson*, 516 F. Supp. 732 (N.D. Fla. 1981); *First Federal Savings & Loan Association of Phoenix* v. *Development Management Enterprises, Inc.*, No. 79-880 (D. Ariz. Apr. 2, 1981); *Dantus* v. *First Federal Savings & Loan Association of*

federal appeals court has held, in a different context, that the Board's authority is limited to regulating the internal affairs of savings and loan associations. See *Gulf Federal Savings & Loan Association of Jefferson Parish* v. *Federal Home Loan Bank Board, supra,* 651 F. 2d at 266. The Board thus recognizes that it is appropriate for this Court to give plenary consideration to the scope of its congressionally-authorized power in this area.

2. Even if the issue in this case were a matter of first impression, the Board believes that the effect of the Court of Appeal's decision is so detrimental to the Board's overall effort to provide for the availability of mortgage funds that the Court of Appeal's decision would be appropriate for plenary review by this Court. When it announced its approval of due-on-sale clauses, the Board recognized that such provisions further three goals that are crucial to maintaining the viability of savings and loan associations: (1) due-on-sale clauses permit lenders to evaluate the credit worthiness of each individual who becomes indebted to them; (2) due-on-sale clauses permit lenders to increase the interest they can charge on long-term loan commitments during periods of rising interest rates and increase the amount of money available for new mortgages; and (3) due-on-sale clauses shorten the average life of conventional mortgages and facilitate the operation of the secondary market for mortgages.[8] See Federal Home Loan Bank Board, Resolu-

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Denver, 502 F. Supp. 658 (D. Colo. 1980), appeal pending, No. 80-2342 (10th Cir.); *Price* v. *Florida Savings & Loan Association,* No. 79-974 (M.D. Fla. Sept. 1, 1981).

[8]This secondary market was created by Congress in 1970 when it established the Federal Home Loan Mortgage Corporation Act ("FHLMC"), 12 U.S.C. (& Supp. III) 1451 *et seq.* and expanded the powers of the Federal National Mortgage Association Charter Act, 12 U.S.C. (& Supp. III) 1717(b)(2). On a nationwide basis, the FHLMC purchases conventional mortgages or interests therein from mortgage originators such as savings and loan associations. The mortgages purchased are resold by the FHLMC to institutional investors in the form

tion No. 75-647, *supra*, at 19-20. The last two of these goals will be significantly undermined if the applicability of the Board's regulation allowing due-on-sale clauses is made to depend on the law of each state.

The combination of spiraling interest rates, which increase the cost to savings and loan associations of acquiring money, and the existence of fixed, long-term loan commitments at lower interest rates has placed the entire federal savings and loan system in a precarious financial situation. During last year alone, the Board estimates that the net worth of all federally insured savings and loan associations was reduced by $1.245 billion. The due-on-sale clause is one of the few contractual tools available to these associations to update the conventional mortgage portfolio in an attempt to remain financially viable.

If lenders are denied this contractual right, interest rates will not be reduced in the long run. Instead, lenders simply will be forced to increase significantly the interest rates charged on new mortgages or abandon completely the concept of a fixed-rate mortgage. The effect will be that existing borrowers will receive a windfall contrary to the terms of their contracts and new borrowers will be exposed to higher interest rates and shortages of funds. Accordingly, enforcement of due-on-sale clauses is essential to safeguard the interests of both the borrowing public and federal savings and loan associations. See Federal Home Loan Bank Board, Resolution No. 75-647, *supra*, at 21-24.

The decision of the Court of Appeal also will have an injurious effect on the secondary mortgage market (see note 8, *supra*). A lender's inability to enforce a due-on-sale clause

---

of mortgage pass-through securities and the funds received are used for further purchases of mortgages. This process increases the availability of residential mortgage credit and, accordingly, provides credit to home purchasers at decreased interest rates.

will unquestionably result in an increase in the average life of mortgage pass-through securities and a corresponding decrease in the attractiveness of these securities. Federal Home Loan Bank Board, Resolution No. 75-647, *supra*, at 31-33. The potential adverse impact upon the national secondary mortgage market will be considerable. For example, the Federal Home Loan Mortgage Corporation[9] alone has purchased $22.4 billion in conventional mortgages which was possible only because the FHLMC could fund these purchases through secondary market sales of mortgage pass-through securities. If this market evaporates because due-on-sale clauses are unenforceable in some states, the ultimate effect will be that more money will be tied up in existing mortgages and funds will be unavailable for new mortgages at more reasonable interest rates.

---

[9]The decision of the Court of Appeal creates an additional difficulty for the secondary mortgage security market. By declaring that the covenant in the deed of trust dealing with the law to be applied was intended to prefer state over federal law, the decision will have the effect of eliminating the national uniformity in these instruments that is designed to make them attractive to investors in a national, secondary market. 12 U.S.C. (& Supp. III) 1451. To the extent that this market shrinks, immediately available funds for new mortgages will be reduced correspondingly and ultimately cause interest rates to rise.

The Board believes the Court of Appeal's interpretation of the FHLMC's Covenant 15 was plainly wrong, but will not treat that point separately in this brief since the Court of Appeal regarded it only as a subordinate part of its preemption analysis.

CONCLUSION

Probable jurisdiction should be noted.

Respectfully submitted.

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Appellee's Reply Brief

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JOHN D. WHITCOMBE,
Appellee.

**On Appeal From the California Court of Appeal
Fourth Appellate District.**

REPLY TO AMICUS BRIEF OF FEDERAL HOME LOAN BANK BOARD.

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REPLY TO AMICUS BRIEF OF FEDERAL HOME LOAN BANK BOARD.

ARGUMENT.

A. The FHLBB Is Limited to Control of Internal Affairs of Federal Associations.

The decision of the California Court of Appeal is premised upon the belief that the Federal Home Loan Bank Board (the "Board") is authorized to promulgate regulations pertaining to the regulation and management of federal savings and loan associations. (A.J.S. p. 17a)

Appellants contend that the distinction drawn by the Court of Appeal between internal and external regulation, is inconsistent with other appellate court decisions. (See Brief for Federal Home Loan Bank Board as *Amicus Curiae*, "B.A.C." p. 5) However, a review of "other appellate court decisions" indicates the contrary. In *Conference of Federal Savings and Loan Associations v. Stein*, 604 F. 2d 1256, 1257 (9th Cir. 1979), aff'd. 445 U.S. 921 (1980), this Court summarily affirmed a decision which specifically involved statutes attempting to regulate the internal affairs of the federal associations. *People v. Coast Federal Savings and Loan Association*, 98 F. Supp. 311 (S.D. Cal. 1951), contrasted the attempts by state regulatory and supervisory agencies to meddle with internal affairs, with the debtor-creditor relationship the bank shares with its patrons, an external matter regulated by state law. The Court concluded the Board's control preempted any endeavors by state agencies to govern internal management. *Kupiec v. Republic Federal Savings & Loan Association*, 512 F. 2d 417 (1st Cir. 1979), also decided in favor of the federal associations, involves a dispute over the means of communication between members of an association, a purely internal matter. In *Kaski v. First Federal Savings and Loan Association of Madison*, 72 Wis. 2d 132, 240 N.W. 2d 367 (1976), the

court spoke of "the broad regulatory powers" the Board may exercise pertaining to internal management.

Significantly, the decision of the California Court of Appeal concurs with the recent opinion in *Gulf Federal Savings and Loan Association v. Federal Home Loan Bank Board*, 651 F. 2d 259, 266 (5th Cir. 1981). The Fifth Circuit Court of Appeals interpreted the Home Owner's Loan Act of 1933, 12 U.S.C. (Supp. III) 1461 *et seq.*, ("HOLA"), as "authorizing the Board to issue and enforce regulations governing the management of federal savings and loan associations", *Gulf Federal, supra*, 651 F. 2d at 262. Restricting the Board's powers to prohibit an "open-ended supervision" of the savings and loans, the Court stressed that the Board should be restrained from "becoming the monitor of every activity" of the federal associations as it would depart entirely from the congressional concept of "acting to prevent financial collapse". *Gulf Federal, supra*, 651 F. 2d at 265.

The Court in *Gulf Federal, supra*, correctly concluded that while the Bank Board had the authority under federal law to regulate the *internal* affairs of the Federal Savings and Loan Association, the loan contracts between the Association and the borrower were controlled by *state law*. The California Court of Appeal decision is consistent with the Court in *Gulf Federal, supra*.

Thus, numerous appellate courts have determined the scope of the Board's authority is clearly limited to regulating the internal affairs of savings and loan associations. Likewise, the California Court of Appeal followed this reasoning in the matter at hand. Any further delineation by this Court is unnecessary at this time.

B. Pending Legislation Would Render This Action Moot.

The substantial controversy raised over the automatic enforcement of the due-on-sale clauses by federal savings and loan associations has prompted dramatic changes in the regulations controlling real estate loans. The Federal Associations now have available variable interest rate loans (12 C.F.R. §545.6-4 (c)); adjustable interest rate provisions (46 Fed. Reg. 24128); 46 Fed. Reg. 32013 (decreases liquidity requirement) and the Economic Recovery Act of 1981, Section 301, 97 Stat. ___ which allows tax-free accounts.

In addition to the above changes, there is pending legislation which addresses the issue involved in this case. These bills, S. 1720 and S. 1703, succinctly provide for federal preemption of any state law prohibiting enforcement of the due-on-sale clause.

The consideration in this matter is appropriately situated in the legislation.[1] The federal associations are requesting Congress to specifically legislate a preemption of state law limitations on due-on-sale enforcement. If any modification of the law concerning enforcement of due-on-sale clauses is necessitated by the controversy raised herein, Congress will enact the appropriate remedy. Therefore, it is proper for this Court to affirm the opinion of the California Court of Appeal without a hearing or dismiss the appeals by Fidelity Federal.

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[1]This was recognized in the California Court of Appeal slip opinion at p. 18, "The decision whether to displace state law is a fundamental one going to the very fabric of federalism; thus, the decision is one to be made by the people through their elected representatives in Congress rather than by agencies or tribunals insulated from democratic pressures".

Conclusion.

A substantive distinction between internal and external regulation of federal savings and loans has clearly been established by numerous appellate courts. Pending legislation will render moot the nature of this due-on-sale issue. Therefore, acceptance of the instant case would be an improvident use of the Court's time.

DATED: December 10, 1981.

Respectfully submitted,

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Appellant's Brief

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APPELLANTS' BRIEF ON THE MERITS

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QUESTIONS PRESENTED.

The Federal Home Loan Bank Board, an agency of the United States, acting pursuant to Section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. § 1464), adopted regulations (12 C.F.R. § 545.8-3) reaffirming the authority of federal savings and loan associations, which it charters and regulates, to include and enforce "due-on-sale" clauses in mortgage loan contracts which permit a loan to be called if the borrower transfers the real property which secures the loan, and, in accordance with the Supremacy Clause (Art. VI, cl. 2) of the United States Constitution, proclaimed that the exercise of such "due-on-sale" clauses by federal associations shall be governed only by those regulations.

The California Court of Appeal has held such mortgage loan contract clauses to be subject to California law, and as such unreasonable restraints on alienation in most situations as to which these clauses are exercised by reason of Civil Code § 711, as interpreted in *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978). The following questions are presented:

1. Whether the Federal Home Loan Bank Board due-on-sale clause regulations adopted pursuant to the Home Owners' Loan Act of 1933 preempt from state authority the due-on-sale clauses in mortgage loan contracts between borrowers and federal savings and loan associations.

2. In the event the first question is answered in the affirmative, whether a different clause in the mortgage loan contract making the contract subject to the law of the jurisdiction in which the real property security is located, nevertheless would make the due-on-sale clause subject to California law.

PARTIES TO THE PROCEEDING.

Appellants: Fidelity Federal Savings and Loan Association ("Fidelity Federal"), a federally chartered mutual corporation and Gateway Mortgage Corporation ("Gateway"), a wholly-owned subsidiary of Fidelity Federal. The only entity required to be disclosed by Rule 28.1 of this Court is Fidelity National Trust Company, a subsidiary of Fidelity Federal.

Appellees: Reginald D. de la Cuesta, Margaret de la Cuesta, Alphonso Moore, Alice Moore, and John D. Whitcombe.

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APPELLANTS' BRIEF ON THE MERITS

OPINIONS AND JUDGMENTS BELOW.

The opinion of the California Court of Appeal, Fourth District, from which this appeal is taken was entered on July 2, 1981, and is published as *Reginald D. de la Cuesta v. Fidelity Federal Savings and Loan Association*, 121 Cal.

App. 3d 328, 175 Cal. Rptr. 467 (4th Dist. 1981), and is reproduced at J.S. App. la. The modification to that opinion upon denial of rehearing on July 22, 1981 is reproduced at J.S. App. 27a. The trial court Order Granting Summary Judgment and the Judgment entered by the Superior Court of California for the County of Orange are reproduced at J.S. App. 29a and 30a, respectively.

JURISDICTION OF THIS COURT.

This is an appeal from a decision of the California Court of Appeal, Fourth District. The decision was entered by that Court on July 2, 1981 (J.S. App. la), and a timely Petition for Rehearing was denied on July 22, 1981 (J.S. App. 27a). A timely Petition for Hearing to the California Supreme Court was denied on August 26, 1981 (J.S. App. 28a). Notice of Appeal was thereafter filed with the Court of Appeal on October 14, 1981, and the appeal was docketed in this Court in accordance with Rule 12 on October 20, 1981, within 90 days of the California Supreme Court's denial of hearing (J.S. App. 32a).

This appeal is taken and jurisdiction invoked pursuant to 28 U.S.C. § 1257(2). Probable jurisdiction was noted on January 25, 1982.

CONSTITUTIONAL PROVISIONS, STATUTES AND REGULATIONS INVOLVED.

This appeal involves the Supremacy Clause (Art. VI, cl. 2) of the United States Constitution, Section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. § 1464(a)), Federal Home Loan Bank Board Regulations 12 C.F.R. § 545.8-3(f) and (g), and 12 C.F.R. § 556.9(f), Federal Home Loan Bank Board Resolution 76-296, and California Civil Code § 711. Each of these provisions is set forth in full, or in pertinent part, commencing at J.S. App. 36a.

STATEMENT OF THE CASE.

The controlling facts in this consolidated case are not in dispute. Appellant Fidelity Federal is a federal savings and loan association chartered and regulated by the Federal Home Loan Bank Board ("Bank Board") (R. 219, 889) pursuant to Section 5(a) of the Home Owners' Loan Act of 1933 (12 U.S.C. § 1464(a)) ("HOLA").

Appellant Fidelity Federal, as its primary business activity, makes long term loans for the purchase of real property, which loans are in turn secured by deeds of trust on the real properties so purchased by the borrowers. Fidelity Federal is the beneficiary under these deeds of trust while Gateway, Fidelity Federal's subsidiary, is the trustee named in the deeds of trust. (J.A. 14, 58, and 93; R. 313).

The Appellees are each successor purchasers (hereinafter "Purchasers") of real property which at the time of purchase was subject to a deed of trust to secure a loan earlier made by Fidelity Federal to the transferors of that property. (J.A. 5-6, 49-50, and 84-85). In each instance the transferors sold the property without prior notice to Fidelity Federal and without the prior written consent of Fidelity Federal despite the due-on-sale provision in each deed of trust which provides that if the real property is transferred without Fidelity Federal's prior written consent Fidelity Federal may call the loan (a "due-on-sale clause"). (J.A. 24, 68, and 103). None of the Purchasers has entered into a mortgage loan contract with Fidelity Federal.

As a result of the unconsented-to transfer to each Purchaser, Fidelity Federal exercised the due-on-sale clause in its deeds of trust and accelerated the maturity of the principal balance due on the secured promissory notes. When the principal balance was not paid Fidelity Federal commenced nonjudicial foreclosures on the real property securing the

loans. (J.A. 38, 76, and 118). Fidelity Federal would have consented to the transfers of the real property and would not have commenced foreclosure proceedings had the Purchasers been willing to have the interest rates on the promissory notes increased to then prevailing market rates. (J.A. 7, 52, and 87).

The Purchasers thereupon each commenced actions in the California courts to enjoin the foreclosure and for damages. (J.A. 5, 49, and 84). The Purchasers contended in their complaints that by reason of Civil Code § 711, as construed by the California Supreme Court in *Wellenkamp v. Bank America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978), the ordinary exercise by Fidelity Federal of its rights under the due-on-sale clause was invalid as an unlawful restraint on alienation. (J.A. 8, 53, and 88). That decision specifically precludes exercise of a due-on-sale clause for the purpose of increasing the interest yield on the lender's loan portfolio. (21 Cal. 3d at 952). Manifestly, nothing in the mortgage loan contracts prevented a sale of the real property security. The contracts prevent only the sale of the loans made by Fidelity Federal to the previous owners when those properties are sold.

Fidelity Federal, in its answers to the complaints, as an affirmative defense, raised the principal question here presented. Fidelity Federal alleged that as a federally chartered and regulated savings and loan association Civil Code § 711 could not validly be applied to prevent its due-on-sale conduct because that section was preempted by the HOLA and the due-on-sale regulations adopted thereunder by the Bank Board. (J.A. 47-48, 82, and 129).

Following consolidation of the Purchaser's individual actions, cross-motions for summary judgment were filed. (R. 846 and 986). Fidelity Federal continued to rely on its defense that Civil Code § 711, as construed in *Wellenkamp*,

could not validly be applied to it due to preemption by federal law. The Purchasers argued below that the federal law was not preemptive (R. 1019-1082), and that in any event, by including in certain of the deeds of trust a clause which stated that the "law of the jurisdiction" where the real property security is located would govern Fidelity Federal made state law applicable. (R. 1006-1078). Fidelity Federal, in opposition, argued, as this Court has held, that the Supremacy Clause of the United States Constitution makes federal law a part of the law of the jurisdiction of each of the States by preempting contrary state law thereby leaving the Bank Board regulations as the law of the jurisdiction. (R. 554-556, 560).

The trial court granted Fidelity Federal's motion for summary judgment holding that Civil Code § 711 was preempted by federal law. (J.S. App. 29a). The trial court did not expressly rule on the "law of the jurisdiction" issue but by necessary implication found that preemptive federal law was a part of the "law of the jurisdiction."

The Purchasers appealed to the California Court of Appeal, Fourth District. Fidelity Federal, as respondent below, continued to rely on federal preemption and the precedent of this Court. The California Court of Appeal reversed the trial court's grant of summary judgment and ordered summary judgment in favor of each of the Purchasers. (J.S. App. 1a, 21a, 22a and 26a). The Court of Appeal held that neither the HOLA nor the Bank Board regulations preempted Civil Code § 711. (J.S. App. 9a, 17a, 21a). The Court of Appeal also stated that the law of the jurisdiction clause in both the *Moore* and *Whitcombe* deeds of trust was an agreement by Fidelity Federal to follow California law (meaning California law without the Bank Board regulations). (J.S. App. 20a).

Fidelity Federal sought rehearing from the California Court of Appeal as to the questions presented here, but rehearing was denied. (J.S. App. 27a). Fidelity Federal then petitioned the California Supreme Court to grant a hearing to review the questions here presented. On August 26, 1981 the petition for hearing was denied by the California Supreme Court, without comment. (J.S. App. 28a).

SUMMARY OF ARGUMENT.

The Bank Board, acting pursuant to section 5(a) of HOLA, by regulation, has permitted federal savings and loan associations to include and exercise due-on-sale clauses in mortgage loan contracts between these associations and their borrowers. (J.S. App. 40a-42a). The State of California, acting pursuant to California law, has severaly limited the exercise of due-on-sale clauses in California. (*Wellenkamp, supra*). The decision below applies those severe limitations to federal associations. HOLA specifically authorizes the Bank Board "under such rules and regulations as it may prescribe to provide for the organization, incorporation, examination, operation and regulation of (Federal) associations . . .". (J.S. App. 37a). Regulations adopted under this broad authority preempt any contrary state law. *Conference of Federal Savings and Loan Ass'ns v. Stein*, 604 F.2d 1256, 1260, *aff'd mem.*, 445 U.S. 921 (1980). The Bank Board due-on-sale regulations explicitly assert the intention of the Bank Board to supplant any contrary state law. (J.S. App. 40a-42a; *See also* J.S. App. 43a-49a). The published justification for the Bank Board regulations are that the due-on-sale mortgage loan provision is necessary to the financial viability of federal associations and is a means of making mortgage credit available to borrowers at costs which are less than costs would be in the absence of the due-on-sale practice. (J.S. App. 43a; *see also* R. 953-

954). These purposes are well within the authority given the Bank Board to issue regulations as contained in section 5(a) of HOLA.

The arguments made by the Purchasers that the Bank Board does not have the authority to deal with the due-on-sale provisions of mortgage loan contracts because these provisions (1) are peculiarly local matters, (2) are "external" matters as to federal associations and therefore not subject to Bank Board regulation, and (3) the regulations are in any event permissive and therefore not preemptive of state law, are without merit. The mortgage loan relationship between federal associations and their borrowers is a primary reason for the enactment of HOLA and is recognized by the courts and the Congress to be within the authority of the Bank Board to regulate. (*Conference, supra*; *Meyers v. Beverly Hills Federal Savings and Loan Ass'n.*, 499 F.2d 1145 (9th Cir. 1974); *Kaski v. First Federal Savings and Loan Association*, 72 Wis. 2d 132, 240 N.W. 2d 367 (1976); 124 Cong. Rec. H. 11743-11745 (October 5, 1978); and 124 Cong. Rec. S. 18471-18472 (October 12, 1978)). The internal/external argument has no support in the language or the legislative history of the HOLA. Similarly, the Bank Board due-on-sale regulations do not fail to preempt because they authorize but do not compel federal associations to exercise due-on-sale contract rights. (*Meyers, supra*).

Although the Bank Board's due-on-sale regulations were first published in 1976, the regulations were directed both to loans which were in existence at that time as well as loans to be made thereafter. The regulations state that federal associations "continues" to have the right to utilize due-on-sale clauses (12 C.F.R. § 545.8-3(f)), but add limitations on that right (12 C.F.R. § 545.8-3(g); J.S. App. 40a). In 1976, and previously to that year, the law of California

authorized all lenders to exercise due-on-sale contract rights (*Coast Bank v. Mindenhaut*, 61 Cal. 2d 311, 38 Cal. Rptr. 505 (1964)). The Supreme Court of California in 1978 reversed its previous decision on the due-on-sale issue. (*Wellenkamp, supra*).

The Court below commented that Fidelity Federal, pursuant to paragraph 15 of its mortgage loan contract had agreed to be governed "by the law of the jurisdiction" in which the real property security is located. (J.S. App. 19a-20a). This Court has held that the "law of the jurisdiction" includes any applicable federal laws and regulations. (*Hauenstein v. Lynham*, 100 U.S. 483 (1880)). Thus, the preemptive provisions of the due-on-sale regulations constitute a controlling element of the law of California in respect to the due-on-sale contract rights of federal associations.

ARGUMENT.

The California Court of Appeal in reversing the trial court's grant of summary judgment for Fidelity Federal acknowledged that the Federal Home Loan Bank Board ("Bank Board") fully intended to preempt state law when it adopted its due-on-sale regulations (J.S. App. 15a). However, the court below concluded that the regulations were nonetheless not preemptive because Congress had not intended that the Home Owners' Loan Act of 1933 (12 U.S.C. § 1461 et seq.) ("HOLA") should be preemptive of state restraint on alienation laws. The Court of Appeal added, by way of dicta, that to the extent Fidelity Federal utilized the FNMA/FHLMC form deed of trust containing a paragraph 15 "law of the jurisdiction clause" Fidelity Federal had agreed to have California state law apply. (J.S. App. 19a). By its decision the California Court of Appeal grossly misconstrued the Home Owners' Loan Act of 1933, and specifically section 5(a) thereof (12 U.S.C. § 1464(a)), misapplied the preemption doctrine, and finally it failed to follow the decisions of this Court as to the content of the law of the jurisdiction.

I.

THE BANK BOARD DUE-ON-SALE REGULATIONS PREEMPT STATE LAW.

A. The Preemption Doctrine.

At the heart of this action is the preemption doctrine. The preemption doctrine emanates from the Supremacy Clause of the United States Constitution (Art. VI, cl. 2). In pertinent part that clause reads:

> This Constitution, and the Laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land; and the Judges in every State shall be bound thereby, anything in the Consti-

tution or laws of any State to the contrary notwithstanding.

This Court held at an early date that if Congress has the constitutional power to act, and intends that its act be controlling, then the Supremacy Clause makes it so. *See McCulloch v. Maryland*, 17 U.S. (4 Wheat.) 316 (1819).

There is no question raised in this appeal as to the constitutionality of the HOLA.[1] The issue here is solely one of congressional intent. Did Congress intend when it adopted the HOLA, and specifically section 5(a) thereof, that its enactment and the regulations of the Bank Board adopted by it in accordance with its mandate be preemptive of state law?

This Court has noted that congressional intent to preempt can be explicitly declared on the face of the legislation, or it may be implied. In either event, preemption "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977).

This Court has formulated various approaches to determine whether Congress implicitly intended to preempt. This Court has held that Congress may evidence an implicit intent to preempt where the pervasive nature of the legislation makes reasonable the conclusion that state law should not validly apply, or the federal act may involve a matter of overriding federal interest, or the objective Congress sought to achieve by its legislation may also disclose the intended

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[1]The constitutionality of the HOLA was decided decades ago in *First Federal Savings and Loan Ass'n. of Wisconsin v. Loomis*, 97 F.2d 831 (7th Cir.), *cert. dismissed*, 305 U.S. 666 (1938), and was not put in issue either by the court below or the Purchasers. *See also, Fahey v. Mallonee*, 332 U.S. 245 (1947); and *People, etc. v. Coast Federal Savings and Loan Ass'n.*, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

inapplicability of state law. *Rice v. Santa Fe Elevator Corporation*, 331 U.S. 218, 230 (1947). *See also, Jones, supra*, 430 U.S. at 525-526; and *Bethlehem Steel Co. v. New York State Labor Relations Board*, 330 U.S. 767 (1947). Further, and of greatest significance here, when Congress enacts legislation expressing general *federal* objectives and empowers a federal agency to issue regulations for the purpose of making the legislation effective, regulations adopted by the agency and intended by the agency to displace state law will do so, provided the regulations are not inconsistent with the general *federal* objectives of the legislation. *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978); *United States v. Shimer*, 367 U.S. 374 (1961).[2]

B. Congress Has Given the Bank Board Ample Authority to Adopt Preemptive Due-On-Sale Regulations.

Congress in enacting the HOLA in 1933, and specifically section 5(a) thereof, intended that the Bank Board exercise plenary authority over the lending practices of federal savings and loan associations. Because HOLA was enacted in

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[2]The Court below noted that the area of law involved, real property law, was traditionally an area of state law (J.S. App. 10a), as if to suggest that the Supremacy Clause was of lesser importance in that realm. This notation was fully met by this Court in *Free v. Bland*, 369 U.S. 663, 666 (1962) (where federal regulations applied a rule of survivorship different than the otherwise applicable state rule):

> The relative importance to the State of its own law is not material when there is a conflict with a valid federal law, for the Framers of our Constitution provided that the federal law must prevail. Article VI, clause 2. This principle was made clear by Chief Justice Marshall when he stated for the Court that any state law, however clearly within a State's acknowledged power, which interferes with or is contrary to federal law, must yield.

This Court reaffirmed the validity of Chief Justice Marshall's words just this term when it found state family law preempted in *Ridgway v. Ridgway*, — U.S. —, 102 S.Ct. 49 (1981), No. 80-1070, decided November 10, 1981, citing *Free v. Bland, supra*.

a crisis atmosphere, there is little legislative history available. The stimulus for this legislation, however, has an abundant historical record.

The HOLA is a product of the Depression. Its purpose was to meet the distressed condition of home ownership, and to prevent the recurrence of that condition. It has been estimated that by 1933 40% of all home loans in the United States were in default. (Federal Home Loan Bank Board, *The Federal Home Loan Bank System*, page 17 (1971); *see* Thomas B. Marvell, *The Federal Home Loan Bank Board*, pages 18-19 (1969)). This crisis in home finance had many causes, but in part was the result of prevailing state practices in home financing.[3] These practices included loans which were to be paid out of sinking funds (which funds were lost altogether when the institutions where those funds were maintained closed, yet the home finance debt remained), loans which called for balloon payments, or rollover of principal at specified intervals, and other practices. Mr. Marvell in his book comments that "the states had developed a hodge-podge of saving and loan laws and regulations . . ." T. Marvell, *The Federal Home Loan Bank Board*, page 26 (1969).

The United States in 1933 clearly faced a home financing and thrift industry operated solely according to state law which was in utter disarray. The demise of institutions which had not been operated in a fiscally sound manner, coupled with home mortgage lending practices calling for balloon payments, or rollover of principal, or repayment by sinking fund (the refinancing of which were impossible because of the failure of existing state chartered and regulated thrift

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[3]It should be recalled that prior to the HOLA, all thrift (building or savings and loan) institutions were created and regulated (if at all) under state law.

institutions) forcefully demonstrated to Congress the need for savings and loan associations which were to be regulated in a manner so as to insure their financial stability, thereby insuring that home mortgage financing would be available to the public.

When Congress, in the special session of 1933, considered measures for the relief of homeowners under threat of dispossession, it was confronted with the almost equally urgent problem of devising ways and means to revive thrift and home financing. Immediate relief for distressed homeowners was provided by the refinancing operations of the Home Owners' Loan Corporation. However, *to minimize the possibility of a recurrence of such a crisis, and to strengthen private home financing as an effective instrument of home ownership, assistance beyond temporary relief was imperative*. Moreover, there were 1,555 counties in the United States — approximately one-half of the total number of counties — in which there were no local home financing institutions whatever.

The necessity of dealing with these problems induced Congress to embody in the Home Owners' Loan Act of 1933 provisions for the creation of Federal savings and loan associations as private institutions under Federal charter. The purpose of authorizing the establishment of these institutions was two fold: (1) to provide thrift institutions where such facilities were unavailable or inadequate; and (2) *to combine under Federal charter the best policies and practices developed in the savings and loan industry during the 107 years of its experience*. The organization, incorporation, and supervision of Federal savings and loan associations were vested in the Federal Home Loan Bank Board. (1938 Report of the Board page 44-5).

West Helena Savings and Loan Association v. Federal Home Loan Bank Board, 417 F. Supp. 220,

227 (E. D. Ark. 1976), *aff'd.*, 553 F.2d 1175 (8th Cir. 1977). (Emphasis Added)

The language used by Congress in directing the Bank Board to create federal savings and loan associations, and more particularly to adopt rules and regulations to govern these associations, is found in section 5(a) of the HOLA (12 U.S.C. § 1464(a)). As originally enacted as 48 Stat. 128 c. 64, § 5(a) (1933), and as carried in the section to this date, that section read as follows:

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal Savings and Loan Associations" and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.

This language is broad. It gives the Bank Board wide latitude in the adoption of rules and regulations for the governance of federal savings and loan associations. It says to the Bank Board "go forth and survey the land and create and regulate federal associations according to the best practices you find". As one court stated:

> The statute is one of the type which states a policy, provides for the project under consideration, lays down some general rules and prohibitions, and leaves details to the Board which is authorized by Section 1463.
>
> * * *
>
> The Board is authorized in Section 1464(a) to issue charters for Federal savings and loan associations "giving primary consideration to the best practices of local mutual thrift and home-financing institutions in

> the United States." *Here is an area where the Board is given the duty and authority to make policy. It is supposed to find out what the practices of these institutions are and give primary consideration to the best ones.*
>
> *North Arlington National Bank v. Kearny Federal Savings and Loan Association*, 187 F.2d 564, 565 (3d Cir. 1951). (Emphasis Added)

As to the power conferred upon the Bank Board by section 5(a) of HOLA it has been said "[i]t would have been difficult for Congress to give the Bank Board a broader mandate." *Glendale Federal Savings and Loan Association v. Fox*, 459 F.Supp. 903, 910 (C.D.Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. 1981).

The breadth of the power given to the Bank Board by Congress is readily apparent by surveying only a few of the many decisions upholding various regulations adopted by the Bank Board pursuant to that power. *See*, e.g., *Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1978), *aff'd mem.*, 445 U.S. 921 (1980) (reporting and notice requirements regarding possible discriminatory lending practices)[4]; *First Federal Savings and Loan Association of Boston v. Greenwald*, 591 F.2d

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[4]This Court's summary affirmance of *Conference* is a decision on the merits as to "the precise issues presented *and necessarily decided* by those actions". *Mandel v. Bradley*, 432 U.S. 173, 176 (1977). (Emphasis Added). *See also, Hick v. Miranda*, 422 U.S. 332, 343-345 (1975). To determine the scope of a summary affirmance, resort to the Jurisdictional Statement is necessary. *See, Mandel*, 432 U.S. at 176, and 180 (J. Brennan, concurring). In the Jurisdictional Statement in *Conference* the appellant, Stein (the Secretary of the Business and Transportation Agency of the State of California), argued that Section 5(a) of the HOLA did not empower the Bank Board to issue regulations preemptive of California law pertaining to non-internal matters of federal associations. (Jurisdictional Statement in 79-923 at 24-31, particularly 27-28). The summary affirmance necessary decided that the Bank Board was so empowered by Congress through § 5(a) of the HOLA. The decision in *Conference* should alone virtually compel reversal.

417, 425 (1st Cir. 1979) (payment of interest on escrow accounts); *Meyers v. Beverly Hills Federal Savings and Loan Association*, 499 F.2d 1145, 1147 (9th Cir. 1974) (prepayment penalties imposed by mortgage contracts); and *North Arlington, supra*, (establishment of branch offices).

In each of the foregoing cases the courts found the language of section 5(a) provided the Bank Board wide latitude in the exercise of its judgment in adopting the "best practices" for federal associations. Most importantly, in each of the foregoing cases the courts found the federal regulations valid and controlling, notwithstanding the contrary practices required by state law.

We submit, the language of HOLA, in light of the historical background relating to its adoption is more than broad enough to permit the Bank Board to adopt a regulation for the governance of due-on-sale clauses in mortgage loan contracts between federal savings and loan associations and its borrowers to the exclusion of contrary state law.

C. The Bank Board Due-On-Sale Regulations.

The Bank Board adopted, by Resolution 76-296 (April 28, 1976), regulations and a statement of policy on due-on-sale clauses. (J.S.App. 43a). In that Resolution the Bank Board specifically provided that a federal association's due-on-sale clause practices were to be entirely independent of any state law to the contrary, subject only to federally imposed limitations as to single family dwellings and then only as to loans made after July 31, 1976. (J.S.App. 46a). In the Statement of Policy explaining the regulations the Bank Board concluded:

> Finally, it was and is the Board's intent to have late charges and due-on-sale practices of Federal associations governed *exclusively* by Federal law. Therefore, charging of late charges and *exercise of due-on-sale*

> *clauses by Federal associations shall be governed and controlled solely by section 545.6-11 and the Board's new Statement of Policy. Federal associations shall not be bound by or subject to any conflicting State law which imposes different* late charges or *due-on-sale requirements* . . . . J.S.App. 45a. (Emphasis Added)

The due-on-sale regulations themselves (initially 12 C.F.R. § 545.6-1(f) and (g) now recodified with minor modification not relevant here as 12 C.F.R. § 545.8-3(f) and (g) (J.S.App. 40a-41a)) specifically "continues" a federal association's power to include in its loan instrument a clause "whereby the association may, at its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent." (J.S.App. 40a). It should be noted that this language specifies that the type of due-on-sale clause to be included is one which permits the association, in its sole discretion, to accelerate the balance due upon sale without any requirement that the sale has in any way impaired the association's security.

Prior to adopting the due-on-sale regulations the Bank Board adopted as its formal Resolution No. 75-647 (July 30, 1975) an official opinion with respect to due-on-sale clauses as requested by the United States District Court in *Schott v. Mission Federal Savings and Loan Association*, United States District Court, Central District of California, Case No. CIV-75-366 WMB. That opinion appears as Exhibit B to Fidelity Federal's Motion for Summary Judgment (R. 916). Following an exhaustive analysis of how the due-on-sale clause and its automatic exercise was beneficial to the financial soundness of a federal association, the Bank Board concluded, *inter alia*, that:

(4) The "due on sale" clause is vital and necessary to enable savings and loan associations to adjust their loan portfolios towards current market rates, thereby protecting the associations' financial stability, and enabling them to make new home loans at lower interest rates than otherwise would be necessary to maintain an adequate yield on their mortgage portfolios.

(5) The "due on sale" clause enables savings and loan associations to sell their existing home loans in the secondary mortgage market in an orderly manner, thereby generating new funds for additional residential loans, which otherwise would be unavailable.

(6) Elimination of the "due on sale" clause is likely to cause higher interest rates on home loans generally, and a reduction of home loan funds. (R. 953)

The Bank Board has again most recently reaffirmed why a due-on-sale clause exerciseable at the federal association's option is economically beneficial to a federal association:

> Federal associations are obliged to take reasonable precautions to protect themselves against the economic risks associated with mortgage lending, including the risk that the cost of lendable funds will exceed the yield from existing mortgage loans, and that sharply rising interest rates will reduce substantially the value of existing mortgage assets. In this connection, the *Board has determined that the due-on-sale clause normally is a valuable and often an indispensable source of protection for the financial soundness of Federal associations and for their continued ability to fund new home loan commitments.*
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> 12 C.F.R. § 556.9(f) (J.S.App. 42a). (Emphasis added)

The foregoing, we submit, establishes that the Bank Board has concluded that the ability to enforce a due-on-

sale clause when the real property security is sold is beneficial to the fiscal well being of federal associations and the borrowing public. The Bank Board has concluded that enforcement of the due-on-sale clause at the association's option is a "best practice". The due-on-sale regulations of the Bank Board are clearly consistent with what Congress intended the Bank Board to do when section 5(a) of the HOLA was enacted. *North Arlington, supra*. The California Court of Appeal decision rejects the supremacy of these regulations over California law, even though they were adopted in conformance with the Congressional purpose of HOLA.

D. The *Wellenkamp* Doctrine Is Hopelessly at Odds With the Purpose and Objectives of the Federal Law.

A direct express conflict between state and federal law is not the only conflict which can give rise to preemption. When the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" the state law will be found so inconsistent with federal law that preemption must occur. *Jones, supra*, 430 U.S. 519, 526 (1977).

In the pending action the Court of Appeal, below, failed to consider fully how the policies underlying *Wellenkamp* stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress in adopting the HOLA, and thereby empowering the Bank Board to issue regulations for the federal associations it created. Those purposes and objectives of Congress have been discussed, *supra*. In contradistinction to those federal policies which seek to create financially sound, viable associations, *Wellenkamp* by its very nature reads Civil Code § 711 (J.S.App. 50a) as requiring the lending institution to carry

the full risk of changing economic circumstances. (21 Cal. 3d at 952-953). *Wellenkamp* precludes the association from demanding payment on its note upon a transfer of the property, unless the association can meet the heavy burden of demonstrating that the transfer has impaired its security. (21 Cal. 3d at 953). The state court in *Wellenkamp* found that the overriding state purpose was protection of home owners' equities (21 Cal. 3d at 950-951), notwithstanding that to do so may adversely impact the lending association. As the preclusion of exercise of due-on-sale clauses at the option of the federal association in accordance with the literal terms of the clause does not aid in any manner the financial stability or integrity of federal associations the *Wellenkamp* doctrine is hopelessly at odds with the purpose and objective of the federal law.[5] As such, there is here presented a conflict between state and federal law, which

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[5]That the Bank Board has correctly concluded that the ability of the lender to enforce the due-on-sale clause at its option is necessary for the protection of the federal association is further demonstrated by a recent monograph published by the California Banker's Association, *The Due-On-Sale Issue: Postion Paper* (1981). That organization studied the California mortgage industry after *Wellenkamp* (i.e., after the elimination of due-on-sale clauses enforceable at the lender's option) and determined that an increasingly large percentage of all sales involved some aspect of "creative financing" such as wrap-around (all-inclusive) deeds of trust, second and third deeds of trust, and other devices (*The Due-On-Sale Issue*, at 16-18). Many of these practices are reminiscent of the very lending practices prevailing when HOLA was adopted, as discussed above. Further, the study found that as most of the second and third deeds of trust were short term, it is quite likely that additional foreclosures will occur if the buyers are unable to refinance their properties when those second and thirds come due. *Id.* Had the due-on-sale clause been automatically enforceable, those risks and the consequences of these creative financing transactions would presumably be substantially diminished. It is most ironic that the California Supreme Court's *Wellenkamp* decision may produce the very evil which Congress sought to eliminate when it adopted the HOLA. While the California Supreme Court has the power to so burden state chartered institutions, the Bank Board has been given the power by Congress to protect its federally chartered institutions from such consequences, and it has done so by its preemptive due-on-sale regulations.

conflict the Supremacy Clause resolves in the favor of the federal law and regulations.

E. The Bank Board's Due-On-Sale Regulations Do Not Exceed Its Power.

It has been argued by the Purchasers in their motion to dismiss here (Motion to Dismiss 7), that if the Bank Board's due-on-sale regulations are preemptive of California Civil Code § 711 as construed in *Wellenkamp*, that the Bank Board would be free to invalidate other state laws including those dealing with lien priorities, health and safety, and zoning.[6] The respondents' argument greatly misses the mark.

The Bank Board is, of course, limited by the scope of the power given to it by Congress, and Congress is itself limited by the Constitution. The Bank Board has been given its power for the purpose of creating and regulating federal savings and loan associations so as to insure that they remain viable, financially sound institutions in order to insure that the public will have available to it thrift institutions for their savings and from which they can receive financing for home construction or purchase. Thus, if the Bank Board sought to preempt state laws which do not impinge upon the operations or financial viability and fiscal integrity of federal associations, its efforts would be invalid. The due-on-sale regulations here, however, are not of that character as the state law in issue flatly prohibits federal associations in all but the most limited of circumstances from accelerating old, low-yielding mortgages upon the sale of the secured property so as to reinvest the monies so received in new mortgages at higher market rates of interest. (*Wellenkamp*, 21

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[6]This same argument was made by Stein in *Conference* (Jurisdictional Statement in 79-923 at 29-30). The summary affirmance in *Conference* should be a complete answer.

Cal. 3d at 952-953). There can simply be no dispute that an inability to upgrade its loan portfolio by use of a due-on-sale clause is economically detrimental to the federal association. (*Supra*, at 17-18).

To the extent that the Bank Board does seek to exercise its power beyond the scope of that power as granted to it by Congress, Congress of course has the ability to legislatively overturn the Bank Board's regulations. It is noteworthy that since 1976 Congress has enacted at least six different amendments to section 5 of the HOLA, including amendments to section 5(a) itself.[7] None of those amendments reduced in any way the Bank Board's authority or cast any doubt upon its exercise of that authority in adopting regulations purporting to preempt state law. This Court has itself repeatedly held that when Congress amends an enactment but does not change the regulatory agency's interpretation of its power under the enactment, the agency's interpretation of the statute and its power is presumptively correct. *See, Board of Governors of the Federal Reserve System v. First Lincolnwood Corp.*, 439 U.S. 234, 248 (1978); and *NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 274-275 (1974).

The most recent amendments to section 5(a) even more forcefully demonstrate the preemptive nature of the power delegated to the Bank Board by Congress. The current language of section 5(a) is set forth at J.S. App. 37a-39a. In

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[7]*See*, Pub. L. 95-128, Title IV §§ 401-405, 91 Stat. 1136, 1137, Oct. 12, 1979; Pub. L. 95-147, § 2(a), 91 Stat. 1227, Oct. 28, 1977; Pub. L. 95-630, Title I, §§ 107(a)(3), (c)(3), (d)(3), (e)(3), 111(c), Title II, § 208(b), Title XII, §§ 1202, 1204, Title XVII, § 1701, 92 Stat. 3651, 3655, 3659, 3662, 3668-3670, 3675, 3710, 3711, 3714, Nov. 10, 1978; Pub. L. 96-153, Title III, §§ 325, 326, 93 Stat. 1121, Dec. 21, 1979; Pub. L. 96-161, Title I, § 102, 93 Stat. 1233, Dec. 28, 1979; Pub. L. 96-221, Title III, §§ 304, 307, Title IV, §§ 401-404, 407(a), 408, 94 Stat. 146, 147, 151, 155, 156, 158-160, Mar. 31, 1980.

1978 section 5(a) was amended to include the provisions permitting State mutual savings banks to convert to Federal mutual savings banks. In describing the authority a Federal mutual savings bank would have once converted into federal form, the Act specifically provides that:

> An association which was formerly organized as a savings bank under State law shall be subject to the requirements of State law (including any regulations promulgated thereunder and any sanction for the violation of any such law or regulation) in effect at the time of conversion, in the State of its original charter
>
> (A) pertaining to discrimination in the extension of home mortgage loans or adjustment in the terms of mortgage instruments based on neighborhood or geographical area,
>
> (B) pertaining to requirements imposed under the Consumer Credit Protection Act,
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> if the Board determines that State law and regulations impose more stringent requirements than Federal law and regulations. (J.S.App. 38a).

The clear import of this language, and the only possible reasons for including it in the legislation, is that notwithstanding the otherwise preemptive effect of HOLA and Bank Board regulations, entities which began life as state savings banks would continue when converted to Federal mutual savings banks to be subject to certain state laws, *but only those certain state laws specifically enumerated in section 5(a)*. The clear implication, we submit, is that without such

language the new Federal mutual savings bank would not be subject to any state laws.[8]

F. There Is No Internal Regulation Limitation to the Bank Board's Power.

The Court of Appeal below indicated in its decision that the HOLA was only intended to enable the Bank Board to regulate the "internal" affairs of federal associations and not its external affairs. (J.S. App. 16a). The Court of Appeal then decided that federal association due-on-sale practices are "external" affairs and, therefore, state law and not the Bank Board regulations would control.

The California Court of Appeal cited several cases for its proposition that the Bank Board may only regulate the internal affairs of federal associations including *Conference, supra; Meyers v. Beverly Hills Savings and Loan Association*, 499 F.2d 1145 (9th Cir. 1974); *Kaski v. First Federal Savings and Loan Association of Madison*, 72 Wis. 2d 132, 240 N.W. 2d 367 (1976); and *Derenco Inc. v. Benjamin Franklin Federal Savings and Loan Association*, 281 Or. 533, 577 P.2d 477 (1978). An analysis of these decisions demonstrates that: (1) none of these decisions turned on the artificial internal/external distinction made by the California Court of Appeal, and (2) even assuming that such a dis-

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[8]That the limitations on new Federal mutual savings banks would not be applicable to existing Federal savings and loan associations is made particularly clear by the legislative history. See 124 Cong. Rec. H. 11743-11745 (October 5, 1978); and 124 Cong. Rec. S. 18471-18472 (October 12, 1978). Congressman Hanley, who offered the specific amendments in the House, commented:

> In no way, of course, would the use of State law requirements for Federal mutual savings banks be interpreted to erode the Bank Board's long-standing plenary authority over Federal savings and loan associations; Federal law alone would continue to govern these institutions in such areas as branching, anti-discrimination, and lending authority.
>
> 124 Cong. Rec. H. 11744 (Oct. 5, 1978)

tinction legitimately can be made, the operation and regulation of the due-on-sale clause at issue here is no different in character or degree from the "internal" regulations found preemptive in the cited cases. Further, an analysis of HOLA demonstrates that HOLA has historically dealt with the terms and conditions of lending instruments. Accordingly, it cannot be properly said that the HOLA was intended to only deal with internal matters of federal associations.

In *Conference*, the Court held that the federal association in its dealings with its borrowers and potential borrowers, because of federal preemption, was not required to comply with certain state non-discrimination laws.[9] (604 F.2d at 1260). In *Meyers*, the Court ruled that California laws limiting the prepayment penalties which could be imposed upon borrowers on early payment of their loans could not, because of federal preemption, be applied to federal associations. (499 F.2d at 1147). (A prepayment penalty is of course used to discourage early payment of a loan when market rates of interest are falling so as to keep the association's loan portfolio at as high a level as possible, while a due-on-sale clause is used to accelerate low interest loans upon the sale of the secured property again for the purpose of keeping the association's loan portfolio at high rates). In *Kaski*, the court concluded that federal law, and not state law, would determine the legality of a variable interest rate provision in a promissory note given by a borrower to a federal savings and loan association. (72 Wis. 2d at 140). (A variable interest rate provision is again a device used by an association to insure that the rates received on funds loaned are maintained at market rates of interest.) Finally, in *Derenco* the Supreme Court of Oregon determined that federal law, spe-

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[9]*See* footnote 4, *supra*, as to the effect of this Court's summary affirmance on the internal/external distinction.

cifically Bank Board regulations, and not state law, would control the duty of a federal association to pay interest on impound accounts required by the association in connection with real estate mortgage transactions between the association and its real estate borrowers. (281 Or. at 564-566).

In each of the foregoing cases the Bank Board regulations at issue dealt with the terms and conditions of the lending relationship between the association and its borrowers. In none of the cited cases did the courts consider themselves bound by any internal/external distinction as formulated by the court below. In most of the cases, such a distinction was not even discussed. The due-on-sale clause is no less "internal" than the provisions considered by the above-noted courts. In fact, in *Kaski* the court recognized this expressly by stating that the "regulation of loan practices directly affects the internal management and operations of federal associations and therefore requires uniform federal control." 72 Wis. 2d at 141-142.

Finally, it must be noted that the HOLA when originally enacted created the Home Owners' Loan Corporation, the purpose of which was to exchange its bonds for mortgages held by various financial institutions, including state chartered associations, but only when those mortgages met certain specified criteria. 48 Stat. 128, c. 64, § 4 (1933) (Repealed 80 Stat. 648, § 8(a) (1966)).

> The mortgage exchange program thus had, as one of its effects, the discouragement of state practices concerning the form of mortgage loan contracts and their replacement with contracts conforming to a uniform federal standard.
>
> *Glendale v. Fox, supra*, 459 F.Supp. at 909.

The internal/external distinction is thus an artificial and unreasonable distinction. But, if such a distinction must be made, it is apparent that the HOLA had from its inception

as one of its purposes the promotion of mortgage lending contracts which would lead to financially strong and viable financial institutions at the expense of those contracts which promoted practices that could weaken the financial institutions. The Bank Board due-on-sale regulations do no more.

G. The Bank Board Regulations Need Not Be Mandatory to Be Preemptive.

The Court of Appeal concluded that because the Bank Board's due-on-sale regulations are not mandatory, i.e., do not compel the inclusion or exercise of a due-on-sale clause, that there was no conflict between state and federal law, and therefore no preemption. (J.S. App. 18a-19a). The permissive/mandatory distinction drawn by the court below is a non-sequitur. Under the analysis employed by this Court in *Shimer, supra*, the express intention by the Bank Board to displace state law by regulations not inconsistent with the HOLA should have resulted in the regulations preempting state law. A conflict was not necessary, but even if it were necessary, a conflict exists. State law flatly precludes that which federal law embraces.

The fallaciousness of the Court of Appeal's permissive/mandatory dichotomy is fully demonstrated by the decision in *Meyers, supra*, a decision which, paradoxically, the Court of Appeal inferred was correctly decided (J.S. App. 16a, 17a).

In *Meyers* the Bank Board regulation involved prepayment penalties for early repayment of mortgage loans. Significantly, the prepayment regulations involved in *Meyers* are as permissive as the due-on-sale regulations here:

> "[E]ach borrower from Federal associations on a loan secured by a home or combination of home and business property shall have the right to prepay the loan

> without penalty unless the loan contract makes express provision for a prepayment penalty."
>
> 499 F.2d at 1147, quoting then 12 C.F.R. § 545.6-12(b).

There is absolutely no difference between the permissive quality of the prepayment regulations endorsed as preemptive in *Meyers* and the due-on-sale regulations involved here. Federal associations are no more required to include or exercise prepayment penalty clauses in loan contracts than due-on-sale clauses. The preemptive result obtained in *Meyers* should logically result here as well.

Furthermore, the permissive/mandatory dichotomy is fully answered by the Bank Board's recent policy regulation, 12 C.F.R. § 556.9(f) which states:

> [T]he Board for many years has authorized due-on-sale clauses for use by Federal associations. However, because the Board desires to afford associations the flexibility to accommodate special situations and circumstances, § 545.8-3(f) of this Subchapter by its terms merely authorizes rather than compels the inclusion and exercise of due-on-sale clauses in mortgage loans. (J.S. App. 42a)

This by no means reflects a desire by the Bank Board to relegate due-on-sale clause policy to state law. As if to emphasize that fact 12 C.F.R. § 556.9(f) continues:

> (2) Paragraph (f) of § 545.8-3 confirms the continuing authority of Federal associations to include due-on-sale clauses in their mortgage loan contracts and to exercise such clauses, *subject only to the express limitations contained in § 545.8-3(g). Due-on-sale practices of Federal associations shall be governed exclusively by the Board's regulations, in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise* (including, but not confined to, state law prohibitions against restraints on alien-

ation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers).

(J.S. App. 42a) (Emphasis Added).

A more straight-forward and express intent to have state law preempted and to provide federal associations with the opportunity to take such action as they deem most appropriate in a given due-on-sale situation can hardly be imagined.

H. The Bank Board Due-On-Sale Clause Regulations Apply to Pre-1976 Loans.

The deeds of trust involved in both the *de la Cuesta* and *Whitcombe* cases were executed prior to the June 1976 effective date of the Bank Board regulations. (Joint Appendix at ... and ...). The Bank Board regulations, however, merely codified that which had been consistently its policy prior to the adoption of the regulations. Thus, the regulations begin: "An association continues to have the power to include . . . . (12 C.F.R. § 545.8-3(f)) (J.S. App. 40a). Similarly, the application of limitations only as to post-1976 loans likewise demonstrates an understanding by the Bank Board that pre-1976 loans would not be so limited. 12 C.F.R. § 545.8-3(g) (J.S. App. 40a). This is also consistent with the Oregon Supreme Court's decision in *Derenco, supra,* wherein Bank Board regulations were found to relieve the federal association of its obligation to pay compensation under state law for the use of escrowed funds after the effective date of the federal regulations, even as to escrow accounts created prior to the effective date of the regulations.

Furthermore, the *de la Cuesta* and *Whitcombe* deeds of trust were executed at a time when even California law permitted due-on-sale clauses to be exercised at the association's option on transfers of property. See *Coast Bank,*

supra. The 1976 Bank Board regulations did nothing more than to confirm that the previously executed mortgage loan contract was to be interpreted according to its very terms — that the due-on-sale clause could be exercised as written i.e., upon the transfer of the real property security at the lender's option.[10]

The *Wellenkamp* decision which had the effect of changing the contract the parties had previously agreed to (by adding the requirement that the lender could not exercise the due-on-sale clause unless it first demonstrated impairment of its security following transfer) was not announced until over two years *after* the Bank Board's 1976 due-on-sale regulations. The Bank Board's regulations thus did nothing more than to insulate the contract the parties had previously made from the vagaries of state law, and this was accomplished prior to the *Wellenkamp* decision.[11] The

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[10]See the Joint Appendix at 24 and 103 for the text of the respective due-on-sale clauses in *de la Cuesta* and *Whitcombe*.

[11]If anything, the *Wellenkamp* decision (which by its own terms applies immediately to all deeds of trust outstanding on the date of the finality of that decision (21 Cal. 3d at 954)) is unconstitutionally applied to those deeds of trust as it takes from the lender a vested right, namely, the right to accelerate the maturity of the note at the lender's option upon transfer while giving the lender back nothing in return. In *County of Los Angeles v. Faus*, 48 Cal. 2d 672, 312 P.2d 680 (1957), the California Supreme Court noted that ". . . where a constitutional provision or statute has received a given construction by a court of last resort and contracts have been made or property rights acquired under and in accordance with its decision, such contracts will not be invalidated nor will vested rights acquired under the decision be impaired by a change of construction adopted in a subsequent decision. Under those circumstances, it has been the rule to give prospective, and not retrospective, affect to the later decision." 48 Cal. 2d at 681. See also this Court's decision in *Missouri Pac. Ry. Co. v. State of Nebraska*, 164 U.S. 403 (1896), wherein this Court said: "The taking by a state of the private property of one person or corporation, without the owner's consent, for the private use of another, is not due process of law, and is a violation of the fourteenth article of amendment of the constitution of the United States." 164 U.S. at 417. The Court in *Wellenkamp* recognized that by taking from the lender its right to accelerate at its option under the due-on-sale clause it was effectively giving to the borrower a greater return upon the sale of his property. 21 Cal. 3d at 950-951.

application of the Bank Board's 1976 due-on-sale regulations to existing deeds of trust do not change the terms of the mortgage loan contracts but merely permit these contracts to be enforced in accordance with their terms. Thus, no rational basis exists, we submit, for failing to apply the Bank Board's due-on-sale regulations to all mortgage loan contracts, regardless of when executed.

II.

FIDELITY FEDERAL HAS NOT CONTRACTED TO FOLLOW CALIFORNIA LAW.

Notwithstanding the Court of Appeal's finding to the contrary the only deed of trust involved in this proceeding containing a law of the jurisdiction clause is the one involved in *Moore*.[12] Paragraph 15 of the *Moore* deed of trust (J.A. 67) provides that the "law of the jurisdiction" where the property is located is to govern the deed of trust. The court below concluded that by this language Fidelity Federal essentially agreed to be bound by California law. (J.S. App. 19a-20a). The court below failed to properly consider what is the "law of the jurisdiction" and did not correctly interpret the language of the deed of trust. Most critically, the court below completely fails to recognize the source of (the Federal Home Loan Mortgage Corporation), or the purpose for (to facilitate a nationwide secondary mortgage market) the uniform deed of trust.

A. What Is the Law of the Jurisdiction.

Paragraph 15 of the *Moore* deed of trust is standard language in a deed of trust drafted by governmental agencies to promote the Congressionally sponsored secondary mortgage market (J.S. App. 19a). This paragraph (J.A. 67) does

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[12]Compare Joint Appendix 58-73 with Joint Appendix 93-115. The latter is the deed of trust in *Whitcombe*, the former in *Moore*.

not refer specifically to the local laws of California, to the substantive law of California, or even to the law of California in general. Rather, it refers to the "law of the jurisdiction" where the property is located. The property is located in Orange County, in the State of California, in the United States of America. What then is the law of the jurisdiction? It is the law of the United States and all California and subordinate laws not preempted by the law of the United States.

It has been a controlling principle of federal-state relationships for over 100 years that the law of any locality always includes federal law. In *Hauenstein v. Lynham*, 100 U.S. 483 (1880) this Court stated:

> It must always be borne in mind that the constitution, laws, and treaties of the United States are as much a part of the law of every state as its own local laws and constitution. This is a fundamental principle in our system of complex national polity.
>
> 100 U.S. at 490.

See also, Mondou v. New York, New Haven & Hartford & Co., 223 U.S. 1, 57 (1911)

B. The Purpose of Paragraph 15 Is to Deal With State Conflict of Laws Problems, Not With Federal-State Relationships.

As this Court noted in *Dice v. Akron, Canton & Youngstown R. Co.*, 342 U.S. 359, 361 (1952) the "validity of releases under the Federal Employers' Liability Act raises a federal question to be determined by federal rather than state law." This Court continued, adding ". . . only if federal law controls can the federal Act be given that uniform application throughout the country essential to effectuate its purposes." *Id.*

That federal law and the federal interest should control the interpretation of the meaning of the law of the jurisdiction clause in this particular contract is most appropriate. The contract (the deed of trust) was drafted by the Federal Home Loan Mortgage Corporation as part of its congressionally mandated function of creating a viable secondary market for savings and loan association mortgages. The national importance of the Federal Home Loan Mortgage Corporation secondary market is discussed in the Bank Board's Amicus Brief in Support of Appellant's Jurisdictional Statement at 9-10.[13]

Contrary to the impression fostered by the court below (J.S. App. 11a, n.3), the business of federal savings and loan associations is not purely local. Federally chartered associations, prior to the recent deregulation activity of the Congress had the statutory right (12 U.S.C. § 1464(c)(1)(B)) to make loans within 100 miles of their home offices. For associations headquartered in certain smaller eastern states, loans have been made on a regular basis in two, three or even four different states. These associations may be involved in transactions where the borrower is in one state, the lender's home office is in a second, while the property is in a third. Horrendous conflict of law problems could arise unless the law of one or another state were selected. Hence, the law of the place of the property clause in paragraph 15. But, regardless of which competing state law is selected, federal law by the Supremacy Clause is uniformly applicable in each state, and from transaction to transaction (*Hauenstein, supra*).

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[13]The national importance of the secondary mortgage market and the need for national uniformity both strongly support the use of federal law to interpret this uniform clause in a uniform deed of trust. *See Clearfield Trust Co. v. United States*, 318 U.S. 363, 367 (1943).

The need for uniform application of preemptive federal law, with paragraph 15 being used solely to solve conflict of law questions between competing state laws is now magnified manifold by the passage of the Depository Institution's Deregulation and Monetary Control Act of 1980, which has removed all territorial limitations on the lending activities of federal associations. Public Law 96-221, 94 Stats. 132 at Section 401 of Title IV.

The foregoing interpretation of paragraph 15 also gives meaning to the entire paragraph 15 which refers to non-uniform and uniform provisions of the deed of trust (the due-on-sale provision, paragraph 17 (J.A. 68), is in the uniform portion) and is also consistent with the general rule of contract construction that specific clauses control over general clauses. *Restatement*, Contracts § 236(c), pages 327-328, and Comment on Clause (c) page 330.[14]

Paragraph 17 specifically grants the association the right to exercise its due-on-sale rights at its option (consistent with federal law). Paragraph 17 also specifically provides that the association may waive its right by agreeing with the buyer of the property that the buyer is creditworthy and that the interest rate shall be adjusted to the amount required by the association. These specific and direct authorizations are rendered meaningless if the general language of paragraph 15 is interpreted to select state law over federal law. The language of paragraph 17 retains its vitality if paragraph

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[14]The court below commented that there could be no law contrary to the terms and conditions of the deed of trust if only federal law applied such that the severability language of paragraph 15 would be rendered meaningless. (J.S. App. 20a). This comment fails to recognize the reality that notwithstanding every effort to the contrary the drafter of a legal document might from time to time include or so phrase a clause as to make that clause contrary even to applicable federal law. Paragraph 15 in its entirety would have a salutory effect in that situation.

15 is interpreted as referring only to nonpreempted state law and preemptive federal law.

When paragraph 15 is properly analyzed in context and with the document as a whole, it clearly does not constitute an election by Fidelity Federal to be bound by the due-on-sale law of California.

CONCLUSION.

Congress was compelled to adopt the Home Owners' Loan Act of 1933 because preexisting state regulation of thrift institutions and the home financing industry had been ineffectual. State associations were not regulated with the view to maintaining their stability and the lending contracts they utilized contributed to their instability. The purpose of the HOLA was in large part to create viable federal thrift institutions regulated by the Bank Board in accordance with the "best practices" available, so as to insure the financial integrity and stability of those thrift institutions, and the availability to the public of mortgage funds. One of the "best practices" selected by the Bank Board to accomplish that end is the use of a due-on-sale clause enforceable at the federal associations' option. The Bank Board had the power to adopt the due-on-sale clause regulations and those regulations, being consistent with the purpose and objective of the HOLA, are preemptive of state law.

Finally, Fidelity Federal has not, by utilizing a uniform deed of trust drafted by a federal agency in furtherance of the national interest for which that federal agency was specifically created by Congress, agreed to follow state law to the exclusion of preemptive federal law.

We respectfully request that this Court reverse the patently erroneous decision of the California Court of Appeal, Fourth Appellate District.

Dated: February 24, 1982

Respectfully submitted,

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Appellee's Brief

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No. 81-750
IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

REGINALD D. de la CUESTA, *et al.*,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION *et al.*,

Appellants,

vs.

ALPHONSO MOORE, *et al.*,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

JOHN D. WHITCOMBE,

Appellee.

On Appeal from the California Court of Appeal, Fourth Appellate District.

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Questions Presented.

1. Whether the Home Owners' Loan Act of 1933 (HOLA) evidences congressional intent to preempt the application of state real property and mortgage law to federally chartered savings and loan associations.
2. Whether California's law regarding restraints on alienation conflicts with the HOLA, or with regulations promulgated thereunder, so as to preclude its application to federal associations.
3. Whether the Federal Home Loan Bank Board may nonetheless effect a preemption of California's law regarding restraints on alienation, based on its regulatory powers under the HOLA and its intent to occupy the field of state real property and mortgage law as applied to the federal associations.
4. Whether Fidelity Federal has agreed to follow California law regarding restraints on alienation by including a clause in its deed of trust stating that the contract is governed by the law of the jurisdiction in which the property is located.

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No. 81-750

IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

REGINALD D. de la CUESTA, *et al.*,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

ALPHONSO MOORE, *et al.*,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

JOHN D. WHITCOMBE,

Appellee.

BRIEF FOR THE APPELLEES.

Statement of the Case.

Generally, Appellees are satisfied with Appellants' Statement of the Case.[1]

[1]Appellants are referred to throughout the brief collectively as "Fidelity Federal." Appellees are referred to simply as "Appellees."

However, it is important to note that the deeds of trust at issue in the *Whitcombe* and *de la Cuesta* cases were executed prior to the effective date of the Bank Board "due-on-sale" regulation. The *Whitcombe* trust deed was executed on July 17, 1972 (J.A. 84-85, 93); the *de la Cuesta* trust deed was executed on January 18, 1971 (J.A. 5-6, 14). At those points in time, no federal statute or regulation regarding the "due-on-sale" clause was in effect. The Bank Board's regulation became effective July 31, 1976, originally codified at 12 C.F.R. §545.6-11(f) and (g), now codified at 12 C.F.R. §545.8-3(f) and (g).

Additionally, the Appellees point out that they are no longer purchasers of their real property. (Appellants' Brief on the Merits, 3). The Appellees are the owners of their respective properties, and have been the owners for several years.[2] Under California law, the Appellees are grantees who took title to their property subject to Fidelity Federal's prior recorded security interest. Calif. Civ. Code §864,865.

Finally, Appellees wish to clarify their position regarding the "law of the jurisdiction" provision contained in the deed of trust at issue in the *Moore* and *Whitcombe* cases. (J.A. 51-52, 67-68).[3] Appellees have never contended that the clause means that California law governs Fidelity Federal's internal affairs. (R. 1006-1078; cf., Appellants' Brief on the Merits, 5). Similarly, the Court of Appeal did not state that by including the clause in its trust deeds, Fidelity Federal agreed to follow California law *without the Bank Board regulations*. (J.S. App. 20a; cf., Appellants' Brief

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[2]The de la Cuestas no longer own the subject secured property. However, they maintain an equity interest as beneficiaries under the All-Inclusive Trust Deed.

[3]In the trial court, Appellees alleged and Fidelity Federal admitted the existence of the clause in the trust deed involved in the *Whitcombe* case. (J.A. 86-87; 124). Accordingly, the Court of Appeal applied its reasoning as to the effect of the "law of jurisdiction" clause to the *Whitcombe* case, although the clause in fact is not contained in the *Whitcombe* trust deed.

on the Merits, 5). Appellees' contentions in this regard are set forth fully in Section III, *infra*.

Summary of Argument.

In creating our Constitution, the States and the People surrendered certain enumerated powers to the central government. The laws passed pursuant to those powers are unquestionably the supreme law of the land. However, the powers not delegated to the federal government, nor prohibited to the States, are reserved to the States through the Tenth Amendment.

The power to control real property matters is one such reserved power. *United States v. Little Lake Misere*, 412 U.S. 580 (1973). The States jealously guard the power over real property within their respective borders. Since each state has its own carefully balanced body of real property law, any disruption of that law, if it should be necessary for some important national interest, must emanate from Congress. The Court of Appeal's opinion under review evidences these important federalist concerns.

A. The fundamental and highly valued right to freely sell or otherwise alienate property interests, and the strong state policy in preserving title mobility are preserved in California's statutory and case law. See *Title Guarantee & Trust Co. v. Garrott*, 42 Cal. App. 152 (1919).

1. California Civil Code §711 prohibits restraints on alienation, and applies in a myriad of contexts. The section's absolute prohibition of restraints on alienation has been qualified, so that only unreasonable restraints on alienation are prohibited in California. *Coast Bank v. Minderhout*, 61 Cal. 2d 311 (1964).

2. In the 1970s the California Supreme Court was presented with a series of cases in which novel use of "due-on" clauses was challenged. Loans securing real estate were accelerated upon alienation of property interests for the purpose of updating lenders' loan portfolios. In California, such

accelerations are unreasonable restraints on title mobility, *i.e.*, the justification for the restraint does not outweigh the quantum of the restraint. *La Sala v. American Savings and Loan Association*, 5 Cal. 3d 864 (1971); *Tucker v. Lassen Savings and Loan Association*, 12 Cal. 3d 629 (1974); *Wellenkamp v. Bank of America*, 21 Cal. 3d 943 (1978).

3. California's law regarding the enforcement of due-on-sale clauses is substantive real property law. It is one of many laws defining the rights and interests in real estate of lenders and debtors applicable to federal associations and their borrowers. Calif. Civ. Code §2920, et seq.

B. Over the years this Court has developed certain tests to determine whether federal law has a preemptive effect. The inquiry begins with Congressional intent. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977). In areas traditionally subject to local control, state law will not be preempted unless that was the clear and manifest purpose of Congress. *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1946); *Florida Lime and Avocado Growers v. Paul*, 373 U.S. 132, 147 (1963); *Alessi v. Raybestos-Manhattan Inc.*, ____ U.S. ____, ____, 68 L.ed.2d 402, 416 (1981).

1. Fidelity Federal has virtually abandoned its claim that in enacting the Home Owners' Loan Act of 1933 (HOLA), Congress intended to occupy the field of real estate law with respect to federal associations. However, "an occupation of the field" theory is implicit in Fidelity Federal's emphasis on the Bank Board's broad regulatory powers. The legislative history of the HOLA demonstrates that the federal associations were intended to fit neatly within each state's framework of real estate law. Additionally, 12 U.S.C. §1464(e), as unamended, expresses concern that the associations be "established without undue injury" to existing local mortgage institutions. The competitive edge sought by Fidelity Federal is certainly unfair. One justification originally advanced for federal associations' auto-

matic due-on-sale enforcement was that state chartered institutions could offer variable interest rate mortgages (Calif. Civ. Code §1916.5), while federal associations could not. Bank Board Resolution No. 75-647 (the "Schott Advisory Opinion"). This justification no longer exists. 12 C.F.R. §545.6-2(c).

2. Fidelity Federal implies there is need for national uniformity in real property and mortgage law, especially due-on-sale law, when a federal association extends a loan.

However, Congress has shown no intent to preempt this area in the almost fifty years since the enactment of the HOLA. *Cf. Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624 (1973). Moreover, the Bank Board's due-on-sale regulation itself would not provide uniform results. The decision of whether the due-on-sale clause should even be included in loan documents, and whether to subsequently enforce the clause, is left entirely to the associations' discretion.

For the same reason, the Bank Board's regulation ensures no uniformity for the secondary mortgage market. Indeed, the Federal Home Loan Mortgage Corporation (FHLMC) maintains a policy of enforcing the due-on clause *only when* the secured property is transferred to an irresponsible grantee.

In the absence of congressional intent to preclude application of state law, preemption will result only where there is an actual conflict. *Ray v. Atlantic Richfield*, 435 U.S. 151 (1978). A federal agency's regulation has never been held preemptive of harmonious state law in the absence of congressional intent; the preemption by administrative fiat which Fidelity Federal urges is dangerous to the "presuppositions of our embracing federal system."

3. California's due-on-sale law does not conflict with relevant federal law. The HOLA was enacted to enhance the availability of sources for financing the purchase of homes. California's due-on-sale law enhances the choice

of property ownership, as to whether to own property, and if so, which property to own.

California's due-on-sale law is also consistent with the "full protection" provision of the 1948 Bank Board regulation, 12 C.F.R. §545.6-11(a) (now codified at 12 C.F.R. §545.8-3(a)). The "full protection" provision, read in context, was promulgated to ensure protection of the lender's security interest in the property *under state law*. In California, the due-on-sale clause may be enforced to protect the lender's security interest.

Finally, California's due-on-sale law can be harmonized with the Bank Board's due-on-sale regulation. The regulation authorizes inclusion of the clause in loan documents, as does California's law. The regulation states that the due-on-sale clause, once included in a loan document, is a matter of contract between the association and the borrower. The interpretation and enforcement of contracts is traditionally governed by state law. *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979). Moreover, matters of contract between the association and its borrowers are external affairs of the association not within the domain of the Board's powers. See *Gulf Federal Savings and Loan Association*, 651 F.2d 259 (5th Cir. 1981).

The Court of Appeal's internal/external distinction as to the application of federal or state law to federal associations' activities demonstrates the proper respect for the separate spheres of governmental authority preserved in our federalist system. *Alessi v. Raybestos-Manhattan, supra*. The Court refused to seek out conflict where none clearly exists, *Huron Portland Cement Co.*, 362 U.S. 440, 446, and sought to reconcile the state and federal statutory schemes. *Merrill Lynch, Pierce, Fenner & Smith v. Ware*, 414 U.S. 117, 127 (1973). The internal/external distinction was recognized, either explicitly or implicitly, in the cases on which Fidelity Federal relies. See Section II C, fn. 54, *infra*.

United States v. Shimer, 367 U.S. 374 (1961) does not support Fidelity Federal's position. *Inconsistency* was the pivotal factor in a finding of preemption, as was the situation in *Free v. Bland*, 369 U.S. 663 (1962). Moreover, in *Shimer* administrative intent was relevant only as to an agency's intent to submit to state law. There is no issue in this case regarding the Bank Board's submission to state law.

In the absence of congressional intent to preempt or irreconcilable conflict, Fidelity Federal advances a new theory of preemption, combining occupation of the field pursuant to the Bank Board's broad regulatory powers, with the Bank Board's intent to preempt. The Court of Appeal correctly followed the controlling precedent in determining that federal law does not preempt California's due-on-sale law.

C. Fidelity Federal has included a provision in its trust deed stating that the trust deed "shall be governed by the law of the jurisdiction in which the property is located." ("Paragraph 15"). This provision necessarily includes any preemptive federal law. However, under the federal due-on-sale regulation, Fidelity Federal has the option to follow state due-on-sale law. Given the pervasive reference to state law throughout the trust deed, the reasonable interpretation of Paragraph 15 is that the due-on-sale clause is but one more term of the contract to which state law applies.

ARGUMENT.

I.

CALIFORNIA'S LAW REGARDING RESTRAINTS ON ALIENATION IS A SUBSTANTIVE LAW OF REAL PROPERTY AND MORTGAGES. IT IS NOT A REGULATION OF THE FEDERAL ASSOCIATIONS.

The body of real property and mortgage law has developed separately and distinctly among the states. Each state has its own complex network of carefully balanced laws regarding the ownership, use and transfer of property interests. The need for harmony and predictability in the law applies with peculiar force and strictness in matters relating to property rights [*Abbott v. City of Los Angeles*, 50 Cal. 2d 438 (1958)], and this is especially true with laws affecting real property interests. *Schoonover v. Birnbaum*, 148 Cal. 548, 549 (1906) ("Stability is required in such cases above all others.").

A. The Source of California's "Due-On-Sale" Law.

The right to freely sell or otherwise alienate an interest in real property is recognized as one of the landowner's most fundamental rights. So highly prized is this fundamental right that conditions interfering with the exercise of it were prohibited at common law.

The statute *Quia Emptores*, 18 Edw. I, Chapters 1, 2, was enacted in England in 1290 to eliminate the feudal restrictions upon alienation that prevented the tenant from selling his land without his feudal lord's consent. Ever since that time, the tying up of real property has been regarded as an evil that is incompatible with the inherent rights of citizens to alienate property. *Title Guarantee & Trust Co. v. Garrott*, 42 Cal. App. 152, 157 (1919).

The common law rule prohibiting restraints on alienation was incorporated into California law by statute. California Civil Code §711, unamended since its enactment in 1872, reads simply:

"Conditions restraining alienation, when repugnant to the interest created, are void."

This prohibition of restraints on alienation, absolute in its language, has been qualified by the California Supreme Court. In 1964, the court broke with the common law tradition and held that only *unreasonable* restraints on alienation are prohibited. *Coast Bank v. Minderhout*, 61 Cal. 2d 311 (1964).

In *Coast Bank*, the court stated flatly that any provision in a loan document by which the borrower will not transfer the secured property without the lender's consent is a restraint on alienation.[4] 61 Cal. 2d 315. The court held, however, that under certain circumstances the restraint may be reasonable and therefore permissible.[5]

The original and true purpose of the due-on-sale clause is to protect the lender's security interest in the property. It allows the lender to accelerate the maturity of the debt should the property be transferred to an irresponsible grantee.[6] In the late 1960s, a new purpose was developed

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[4]See Volkmer, *The Application of the Restraint on Alienation Doctrine to Real Property Security Interests*, 58 Iowa L. Rev. 747, 774 (1973), "Although written as an acceleration clause, the due-on-sale clause directly and fundamentally burdens a mortgagor's ability to alienate as surely and directly as the classical promissory restraint. As such, the due-on-sale clause is truly a direct restraint insofar as the category of direct restraints can be articulated." See also, *Title Guarantee & Trust Co. v. Garrott*, 42 Cal. App. 152, 153, "[T]he rule respecting restraints on alienation does not depend upon the mere form whereby the restraint is imposed".

[5]In *Coast Bank*, the court did allow foreclosure of the security pursuant to the "due-on-sale" clause contained in a contract creating an equitable mortgage on the property. But as the court itself has noted, "the case did not present the usual situation involving a deed of trust with a due-on-sale clause." *Dawn Investment Co., Inc. v. The Superior Court of Los Angeles County*, 30 Cal. 3d 695, 698 (1982).

[6]See *Father of the Clause May Bury Corpse*, Los Angeles Times, May 6, 1979, "We [the firm of Snyder & Snyder] drew the very first due-on-sale clause for Gibraltar Savings in the early 1960s . . . Ironically, we devised it to protect lenders against irresponsible buyers, but it was subsequently used as a sword to get higher interest rates" (quoting attorney Harold W. Snyder).

for the clause. Lenders began enforcing the clause to raise the interest rates on existing loans to the current market rates.[7] It is no coincidence that this development paralleled a progressing inflation in the national economy.

A line of cases presented the California Supreme Court with the issue of whether a lender's need or desire to "update its loan portfolio" was a justification making certain "due-on" restraints legally permissible.[8]

The court developed a balancing test in these cases. The enforcement of the "due-on" clause is reasonable if the justification for the acceleration of the debt outweighs the quantum of restraint upon alienation. The lender's economic justification was repeatedly rejected as a basis for enforcement of the "due-on" clause, *i.e.*, it does not outweigh the quantum of the restraint on alienation. See *La Sala v. American Savings & Loan Association*, 5 Cal. 3d 864 (1971) (loan accelerated upon further encumbrance of the secured real estate); *Tucker v. Lassen Savings & Loan Association*, 12 Cal. 3d 629 (1974) (loan accelerated on sale of the secured real estate under a land sale contract); *Wellenkamp v. Bank of America*, 21 Cal. 3d 943 (1978) (loan accelerated on outright sale of the secured real estate).

The *La Sala* and *Tucker* holdings were expressly limited to their fact situations, and therefore did not directly address the acceleration of a loan upon outright sale of the secured

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[7]The procedure by which this adjustment is accomplished is: (1) a contemplated sale, or sale of the real estate by the owner; (2) notification to the lender of the sale or contemplated sale; (3) a letter by the lender demanding either that the entire loan balance be paid in full, or that the owner assume the loan at a higher interest rate; (4) the lender commences foreclosure proceedings on the property under state law unless the owner pays the loan in full or assumes at the higher interest rate; and, (5) the property is sold at a foreclosure sale and the debt is satisfied from the proceeds. The money may then be reissued at current market rates.

[8]The "due-on" clause typically purports to give the lender the right to call the loan not only upon the sale of property, but also upon further encumbrance of the property, leasing with an option to purchase, or alienation of any interest in the property. (J.A. 24, 103).

real estate.[9] But lenders had no reason to expect that when the court was presented with an outright sale situation, the lender's portfolio justification would be accorded any greater significance than in the contexts of further encumbrance or sale under a land sale contract.

Thus, the *Wellenkamp* decision came as no surprise to the lending industry. The court simply applied "the principles set forth in *La Sala* and *Tucker*." 21 Cal. 3d 943, 949. After *La Sala*, and especially after *Tucker*, a lender enforcing the due-on-sale clause solely to update its loan portfolio did so at its peril.

B. California's Due-On-Sale Law Preserves the Mobility of Title in the Face of Shifting Economic Conditions

The California Supreme Court rejected the lender's loan portfolio argument as justification for due-on-sale enforcement because

> "exercise of the due-on clause to protect against this kind of business risk would not further the purpose for which the due-on clause was legitimately designed, namely to protect against impairment to the lender's security that is shown to result from a transfer of title. . . ." 21 Cal. 3d 943, 952-953.

The California Supreme Court determined that California's interest in preserving the free and unfettered mobility of title is paramount to claimed rights derived from shifting economic conditions.[10] The economic risks caused by an

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[9]Outright sale as defined in *Wellenkamp* is a sale of real estate after which the original trustor/owner retains no further ownership interest in the real estate, as distinguished from sale under a land sale contract, where the owner/trustor retains legal title until the purchase price is paid off. 21 Cal. 3d 943, 950.

[10]See also, *Brown v. Avemco*, 603 F.2d 1367, 1376 (9th Cir. 1979), "*Acceleration clauses* are designed to protect the creditor from actions by the debtor which jeopardize or impair the creditor's security. They *are not to be used offensively, e.g., for the commercial advantage of the creditor*. Acceleration is a harsh remedy with draconian consequences for the debtor. Acceleration is a matter of equity and the courts, including those of Texas, have been careful to evaluate the fairness of acceleration in the particular facts of a case." (Emphasis added.)

inflationary economy are "among the general risks inherent in every lending transaction." 21 Cal. 3d 943, 952.[11]

Several *amici curiae* in support of Fidelity Federal's position imply that the California Supreme Court was not interested so much in preserving the free mobility of title to land, as in providing a windfall to sellers of encumbered property. This argument is based on the erroneous presumption that the due-on-sale clause has no real detrimental effect on the free alienation of property. But as the court in *Wellenkamp* noted:

> "The availability of new financing often depends upon general economic conditions. In times of inflation, when money is 'tight' and funds available for real estate loans are in short supply, new financing may be difficult, if not impossible to obtain. The same result may occur when interest rates and the transactional costs of obtaining new financing are high, making it economically unfeasible for the buyer to acquire a new loan." 21 Cal. 3d 943, 950.[12]

The Bank Board, as *amicus curiae* in support of Fidelity Federal's position, implies that in any event the *Wellenkamp* decision is unsound because it permits a few sellers of encumbered property to benefit at the expense of other buyers

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[11]Certainly the possibility of future inflation accounts for some of the discrepancy between the interest lenders charge on their loans and the interest paid by them on various member deposit accounts.

[12]See also, *Falls City v. Missouri Pacific Railroad Co.*, 453 F.2d 771, 773 (8th Cir. 1971), " '[T]he expression "restraint on alienation" refers not merely to the restriction of the legal power of alienation, but also to the restriction of alienability as a practical matter. Any provision in a deed, will, contract, or other legal instrument which, if valid, would tend to impair the marketability of property, is a restraint on alienation. In brief, the law is concerned primarily with practical alienation, not with a theoretical power of alienation.' " (citations omitted).

and sellers, who must pay resultant higher interest rates in financing. (Due-On-Sale Task Force Report, pp. 4, 6, 7-10.)

This argument misses the point. The Court in *Wellenkamp* was concerned with the free and open exchange of property. The true beneficiary of the *Wellenkamp* decision is the California real estate marketplace. The heightened benefit to homeowners having particular loans does not warrant a conclusion that the decision is unsound. See *Wellenkamp*, 21 Cal. 3d 943, 951, fn. 7.

The Court in *Wellenkamp* correctly identified the source of the lender's grievance: inflation, which affects all participants in the general economy. The Court properly rejected the lender's after-the-fact attempt to correct their mistaken economic projections.[13] Attempts to decide who is more severely affected by an inflationary economy as between borrower and lender invite sympathetic discussion from both sides. The *Wellenkamp* decision is sound because, regardless of fluctuations in market conditions, the indispensable condition of unfettered title mobility is preserved.[14]

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[13]The Due-On-Sale Task Force Report states that the lender's inability to enforce the due-on-sale clause increases the expected average life of the loan. (Report, p. 3.) This "average life" is, of course, mostly a lender's expectation, and not even shared by all lenders. Moreover, relying on such fortuitous events as sales of property renders the expectation illusory, and is at best a haphazard method of calculating the lives of groups of loans.

[14]See Posner, *1. The Economic Theory of Property Rights, Economic Analysis of Law*, 10-15 (1973), "The third criteria of an effective system of property rights is *transferability*. If a property right cannot be transferred, there is no way of shifting a resource from a less productive to a more productive use through voluntary exchange. The costs of transfer may be high to begin with; a legal prohibition against transferring may, depending on the penalties for violation, make costs utterly prohibitive." (fn. omitted, emphasis in original).

C. California's Law Regarding Restraints on Alienation Is the Embodiment of an Important and Strong State Public Policy; It Is Not a Regulation of Savings and Loan Associations

Civil Code Section 711 is a substantive law of real property. It is not directed at regulating and is not a regulation of savings and loan associations. It applies to a variety of restraints on alienation.[15]

The doctrine that all interests in land should be alienable is one of two doctrines that were established to prevent the evil of the tying up of real property.[16] The rule rests on "grounds of clear public policy and convenience in facilitating the exchange of property, in simplifying its ownership, and in freeing it from embarrassments which are injurious, not only to the possessor, but to the public at large."

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[15]For example, it applies to a condition in a deed of conveyance *prohibiting the grantee's sale of land under penalty of forfeiture (Mountain Brow Lodge No. 82, I.O.O.F. v. Toscano*, 257 Cal. App. 2d 22 (1968)); to a *clause in a will* imposing a restraint on alienation (*Drexler v. Development Co.*, 172 Cal. 758 (1916)); to conditions or agreements that the *property is not to be sold, leased or rented to one not of Caucasion birth (Los Angeles Investment Co. v. Gary*, 181 Cal. 680 (1920)); (*Title Guarantee & Trust Co. v. Garrott*, 42 Cal. App. 152 (1919)); (*Foster v. Stewart*, 134 Cal. App. 482 (1933)). It also applies to an agreement by a *mother not to convey land without her son's consent*, where the *son furnished the purchase money for the land* conveyed to his mother (*Prey v. Stanley*, 149 Cal. 178 (1895)); to a provision in a deed that *if the grantee should ever sell the land it should be sold to the grantor (Maynard v. Polhemus*, 74 Cal. 141 (1887)); and to a *provision in a trust deed prescriptive of alienation* of a property interest (*Reagh v. Kelly*, 10 Cal. App. 3d 1082 (1970)).

[16]The other doctrine is the rule against perpetuities, codified in California Civil Code §715.2.

Title Guarantee & Trust Co. v. Garrott, supra, 42 Cal. App. 152, 157.[17]

D. Prohibition of Unreasonable Restraints on Alienation Is but One Aspect of California Law Defining Lender/Debtor Relationships

The lender/debtor relationship is defined exclusively by state law. The rights and interests *of each* in secured real estate are protected and limited under state law, which balances the competing interests and provides for each accordingly.[18]

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[17]"The undesirable effect on society potentially resulting from [restraints which make property unmarketable] include: (1) the unnatural increase in the market value of property which might result if restraints were widely employed in a particular locale; (2) the discouragement of improvements to the property, since it may be unprofitable to the owner to make such improvements while threatened with such restraint; (3) the hampering of the most effective use of property if a prospective purchaser would be a more effective user than the present owner; and (4) the removal from trade of an increasing amount of the national capital." H. Bernhard, *Restraints On Alienation*, 57 Mich. L. Rev. 1173, 1179-80 (1959). See *Martin v. Bay View Federal S & L Ass'n.*, pending in the Superior Court of the State of California, County of San Francisco, Case No. 782824, where the transferee made substantial improvements in an apartment building to provide low cost housing, tripling the occupancy. The assumption offered by Bay View Federal in that case would boost the monthly payments so high that rents charged at the legal ceiling rate under the local rent control ordinance would not carry the debt service. Thus, automatic due-on-sale enforcement hampers not only the most effective use of property, but also a city's interest in providing low cost housing through rent control.

[18]For example, a mortgage or trust deed given for the purchase of real estate is given priority over all other liens against the purchaser, subject only to the recording laws (Calif. Civ. Code §2898); the lender may perfect its interest and preserve it as against any subsequent purchasers by recording it under the recording acts (Calif. Civ. Code §1213), but a bona fide purchaser for value and without notice is protected against the lien if the lender fails to record (Calif. Civ. Code §1214); the power of sale in a lender's loan document is authorized by law to provide a speedy and efficient sale of the property in the case of default (Calif. Civ. Code §2932), but the borrower may seek a court-ordered injunction to preserve the status quo while the question of default is being litigated (*Garfinkle v. Superior Court of Contra Costa County*, 21 Cal. 3d 268, 274, fn. 5 (1978), *app. dism.* 439 U.S. 949. See also, *Third National Bank v. Impac Limited*, 432 U.S. 312 (1977)

(footnote continued on following page)

California's law defining the rights and limitations of lenders and borrowers has always applied to federal associations. Each law affects the substantive rights of owners and lenders within the lender/debtor relationship.

The lender's rights and limitations under the due-on-sale law reveal no peculiar need to create an exception because of the federal charter of the lender. The same balancing considerations between owner and lender interests under all other real property laws are present within the body of California's due-on-sale law. Where the security is impaired and/or repayment of the debt is threatened, the lender may enforce the clause. The same reasonableness of security impairment or risk of default requirements for due-on-sale enforcement apply to "private," or non-institutional lenders (*Dawn Investment Co. v. The Superior Court of Los Angeles*

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holding 12 U.S.C. §91 inapplicable to a debtor's actions seeking a preliminary injunction against a national bank to protect his real property from wrongful foreclosure); the procedure for non-judicial foreclosure by the lender is given by Calif. Civ. Code §§2924-2924.6, but the borrower is allowed to cure the default within a certain time period (Civ. Code §2924c); a lender may seek a deficiency judgment against the borrower where sale of the property does not satisfy the debt (Calif. Code of Civ. Procedure §580a), but no deficiency judgment shall lie where the loan was given for the purchase of "residential" real estate which secures the loan (Cal. Code of Civ. Procedure §580b); the lender is protected against "waste" to the property by the owner (Calif. Civ. Code §2929), and may recover a deficiency judgment even under a purchase money mortgage where the owner commits such waste (*Cornelison v. Kornbluth*, 15 Cal. 3d 590, 604 (1975)), but "waste" does not include depreciation of the property caused by market depressions (*id.*); a lender may elect to foreclose under the judicial procedure where a deficiency judgment will lie, but the borrower retains statutory redemption rights; or the lender may forego the right to a deficiency judgment and cause a sale resulting in non-redeemable title (*Roseleaf v. Chierighino*, 59 Cal. 2d 35, 43-44 (1963)); when a lender and borrower modify a previously existing loan, the modified loan may retain priority over junior liens if consent to subordination is obtained from the junior lienholder (Calif. Civ. Code §§2953.1-2953.3), but the junior lienholder may void any subordination agreement which does not comply with those statutes (Civ. Code §2953.4). See also, *People v. Redwood Baseline*, 84 Cal. App. 3d 662 (1978), providing elaborate and detailed guidelines for determining the rights of owners and lenders in the proceeds from an award resulting from a taking of the secured real estate by eminent domain.

County, *supra*, and to loans secured by investment, or commercial real estate. *Id.*

Fidelity Federal's claim of exemption cannot be reconciled with its acceptance of the benefits and protections afforded it under state law. A particularly anomalous feature of Fidelity Federal's position is the state law it uses, and must use, to enforce the due-on-sale clause.

California could not refuse to allow Fidelity Federal the same benefits and privileges provided to state chartered and private lenders. It is grossly unfair for federal associations to exploit state law by accepting its benefits while disclaiming corresponding obligations. "It is a strange argument that permits one to pick and choose what portion of the law binds him." *First National Bank v. Walker Bank*, 385 U.S. 252, 261 (1966).

II.

FEDERAL LAW DOES NOT PREEMPT STATE LAW PROHIBITING UNREASONABLE RESTRAINTS ON ALIENATION; CONGRESS HAS NOT UNMISTAKABLY SO ORDAINED AND THE STATE LAW DOES NOT CONFLICT WITH RELEVANT FEDERAL LAW.

In determining whether a federal enactment precludes a state regulation, the inquiry begins with congressional intent. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977).

State regulation in areas traditionally subject to local control[19] will not be precluded by a federal enactment "unless that was the clear and manifest purpose of Congress." *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1946).

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[19]In a long line of cases this Court has recognized that as a general rule, the areas of real property and mortgage law are governed by state law. See *e.g. Butner v. United States*, 440 U.S. 48, 55 (1979); *State Land Bd. v. Corvallis Sand & Gravel Co.* 429 U.S. 363, 378 (1977); *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 591, 592, (1973); *Hoopeston Canning Co. v. Cullen*, 318 U.S. 313, 318 (1942); *Sunderland v. United States*, 266 U.S. 226, 232-233 (1924).

In recent years this Court has repeatedly emphasized that preemption of state law is not favored in the absence of persuasive reasons — either the nature of the regulated subject matter permits no other conclusion or that the Congress has unmistakably so ordained." *Florida Lime & Avocado Growers v. Paul*, 373 U.S. 132, 147 (1963); *DeCanas v. Bica*, 424 U.S. 351, 356 (1976); *Chicago and Northwestern Transportation Co. v. Kalo Brick & Tile Co.*, ___ U.S. ___, ___, 67 L.ed.2d 258, 265 (1981); *Alessi v. Raybestos-Manhattan, Inc.*, ___ U.S. ___, ___, 68 L.ed.2d 402, 416 (1981); *Commonwealth Edison Co. v. Montana*, ___ U.S. ___, ___, 69 L.ed.884, 905 (1981).

The reluctance to find a total ouster of state law preserves the state-federal balance from unintentional disturbance by Congress and unnecessary disturbance by the courts. *Jones v. Rath Packing Co., supra*, 430 U.S. 519, 525. It is not a reflection of "doctrinaire localism," but is a reflection of the "presuppositions of our embracing federal system." *San Diego Building Trades Council v. Garmon*, 359 U.S. 236, 243 (1959).

In support of its claim that Congress intended the Home Owners' Loan Act (HOLA) to supersede the state real property and mortgage law in question, Fidelity Federal relies on the broad regulatory power granted to the Bank Board,[20] and the comprehensive nature of the federal regulations promulgated by the Bank Board. But the requisite Congressional intent will not be inferred merely from the comprehensive character of the federal program. *New York State Department of Social Services v. Dublino*, 413 U.S. 405,

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[20] "In order to provide local mutual thrift institutions . . . the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations', . . ." 12 U.S.C. §1464(a)(1).

415 (1973); *DeCanas v. Bica, supra,* 424 U.S. 351, 359-360 (1976).

Since in this case there is no express statutory command of preemption, California's law regarding property transfers can justifiably be found preempted only if (1) the implicit legislative design of the HOLA evidences a congressional intent to preempt the application of state real property and mortgage law to federal associations; or (2) there exists a need for national uniformity in real property and mortgage law when a federal association extends a loan; or (3) the states' regulation of real property transfers conflicts with the purposes of the HOLA or with the Bank Board regulations.

A. Nothing in the History, Purpose or Language of the HOLA Evidences a Congressional Intent to Preempt the Application of State Real Property and Mortgage Law to Federal Associations

1. The History of the HOLA.

Prior to the enactment of the HOLA, Congress attempted to remedy the developing emergency in home financing through the enactment of the Federal Home Loan Bank Act (FHLBA), 12 U.S.C. §1421, et seq. The FHLBA provided both for direct advances to lending institutions in order to pump money into the mortgage market[21] and for direct loans to homeowners.

To be eligible for membership in the Federal Home Loan Bank system, the institutions were required to be regulated

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[21] "It [the FHLBA] set up a system of federally chartered Home Loan Banks for the purpose, as stated in the House and Senate Committee Reports, of placing 'long-term funds in the hands of local institutions' in order to alleviate the pressing need of home owners for 'low-cost, long-term, installment mortgage money' and to 'decrease costs of mortgage money' with a 'resulting benefit to home ownership in the form of lower costs and more liberal loans'." *Laurens Federal Savings and Loan Ass'n. v. South Carolina Tax Commission,* 365 U.S. 517, 521-522 (1961) (fn. omitted).

under either state or federal laws and to make such home mortgage loans as, in the judgment of the Bank Board, were long-term loans. 12 U.S.C. §1424(a).

It soon became apparent, however, that the FHLBA was not accomplishing its intended goals. The provision for direct loans to homeowners failed because it lacked an administrative apparatus.[22] In addition, it was discovered that more than half of the counties in the United States did not have institutions eligible for membership in the Home Loan Bank system. As a consequence, these counties obtained no benefit from the direct advance provision of the FHLBA.[23]

The HOLA was enacted to remedy these problems. To remedy the inadequate direct loan provision of the FHLBA, Congress created the Home Owner's Loan Corporation (HOLC).[24] In addition, Congress created the federal associations to serve those counties without institutions eligible for membership in the Home Loan Bank System.[25]

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[22]"Last year we passed the home loan bank bill. There is throughout the country wide dissatisfaction with the operation of that bill . . . I was going on to explain that this amendment [providing for direct loans to homeowners] was inadequate. It did not furnish the machinery for making direct loans . . ." (statement of Representative Luce), 77 Cong. Rec. 2478-2479.

[23]See the statements of Representative Luce: "There are in this country 3,072 counties. There are 1,566, almost exactly half, that have no building and loan associations, no mutual savings bank, and no insurance company, and therefore cannot benefit by the provisions of last year's law . . . For that purpose the latter part of this bill provides an appropriation by the expenditure of which the home loan bank system may encourage and stimulate the creation of thrift associations and may foster them in the 1,500 or so counties that do not have them." 77 Cong. Rec. 2480.

[24]See 77 Cong. Rec. 2479, Statements of Representative Luce.

[25]House Report accompanying the HOLA, H.R. No. 55, 73rd Cong., 1st Sess. 1, 2; Hearings on HOLA, Senate Subcommittee of the Committee on Banking and Currency, 73rd Cong., 1st Sess. 7, 8 (April 20, 22, 1933) (statement of Horace Russell, General Counsel, Federal Home Loan Bank Board); T. Marvel, *The Federal Home Loan Bank Board*, 26 (1969).

The HOLA did not create national savings and loan associations. Congress envisioned *local* mutual thrift institutions accepting deposits from *local* savers.[26] Horace Russell, General Counsel to the Federal Home Loan Bank Board and draftsman of the HOLA, William Stevenson, the first Chairman of the Federal Home Loan Bank Board, and the House Report accompanying the HOLA, all characterized the federal associations as local institutions.[27] Section 5(a) of the HOLA (12 U.S.C. 1464(a)) relates the desire "to provide *local* mutual thrift institutions . . ." (emphasis added).[28]

In contrast to the local nature of the federal associations, the HOLC is designated a federal instrumentality. 78 Stat. 769, §4(a). Thus even though Congress specifically immunized the HOLC from state regulation, Fidelity Federal would have this Court infer that Congress intended also to immunize the federal associations from state regulation. Perhaps Congress inadvertently neglected to express its intent to immunize federal associations from state regulation. In light of its express designation of the HOLC as a federal

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[26]Indeed, these institutions were limited to making loans within fifty miles of their home office. 12 U.S.C. 1464, 48 Stat. 132 (1933). It was not until 1964 (78 Stat. 769, §901(a)) that section 1464(c) was amended to allow associations to lend within one hundred miles of their home offices; and not until 1970 (84 Stat. 450, §706) that federal associations were permitted to lend anywhere within the state in which their home office was located.

[27]This was the understanding of the first Federal Home Loan Bank Board Chairman: "These associations will be cooperative mutual savings funds, substantially all of which funds will be loaned on homes in the community. They will be organized under a Federal charter, *but will operate locally and be managed locally*." S. Doc. No. 74, 73rd Cong., 1st Sess. 4 (1933) (statement of William F. Stevenson, Chairman, Federal Home Loan Bank Board) (emphasis added); see also footnote 25, *supra*.

[28]See also the House Report accompanying the HOLA, "These associations are intended as permanent associations to promote the thrift of the people locally to finance their own homes and the homes of their neighbors." H.R. No. 55, 73rd Cong., 1st Sess. 1, 2.

instrumentality and its characterization of federal associations as local, the more reasonable inference is that Congress did not so intend.[29]

2. The Purpose of the HOLA.

Congress' purpose in creating the federal associations supports the conclusion that Congress did not intend to exempt such associations from all state regulation. As previously noted, Congress expressed the opinion that the proper method of home financing was through amortized long-term loans. However, under the FHLBA, no attempt was made to coerce state chartered institutions into a national system under the exclusive authority of the Bank Board. Rather, the benefits of the provision for direct advances were denied to those institutions which did not make "such home mortgage loans as, in the judgment of the Board, are long-term loans." 12 U.S.C. 1424(a). In addition, institutions which were not subject to inspection and regulation under either state or federal banking laws were required to submit to inspection and regulation by the Board in order to obtain the benefits of the FHLBA. *Id.*

Clearly, Congress was satisfied that the benefited institutions be regulated by either state or federal law and that no uniform regulatory system was necessary to carry out the purposes of the FHLBA. The only uniform rule insisted upon was the Board's determination of what constitutes a "long-term" loan. The history of the HOLA indicates that it and the FHLBA were enacted to achieve similar goals.

Since Congress determined that the discounting activity of the FHLBA did not require uniform regulation of the

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[29]This conclusion is fortified by this Court's admonishment that "we should be slow to strike down legislation which the state concededly had the power to enact, because of its asserted burden on the federal government. For the state is powerless to remove the ill effects of our decision, while the nation... government, which has the ultimate power, remains free to remove the burden." *Penn Dairies, Inc. v. Milk Control Commission*, 318 U.S. 261, 275 (1943).

participating institution, it is unreasonable to infer that Congress intended uniform and exclusive federal regulation of the federal associations under the HOLA.[30]

The very individual who drafted and supervised the operation of the HOLA has questioned, if not denigrated, the colorful "cradle to grave" dicta which is the cornerstone of many of the preemption holdings upon which Fidelity

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[30]In his book, *Savings and Loan Associations* (2nd ed. 1960), Horace Russell describes his close participation in the creation and early development of the federal associations. Mr. Russell drafted the HOLA, as unamended, and his draft became law with very few corrections. *Id.*, 54-56.

Significantly, in Chapter 11 of the book Mr. Russell had this to say concerning the application of state law to the federal associations:

> "[I]n matters of purely local concern, the federal laws are customarily silent, and, indeed, since this field is largely reserved to the states, there is a question of how far Congress could go even if it so desired. Certainly Congress or its administrative agencies could scarcely 'pre-empt' the entire local field. *We say this despite the rather sweeping language used recently by a California court*: 'As to federal savings and loan associations, the Congress made plenary, preemptive delegation to the Board to organize, incorporate, supervise, and regulate, leaving *no field* for state supervision.' " *Id.*, 566-567 (emphasis added).

Of course, the case Russell cites is *People v. Coast Federal S & L Ass'n.*, 98 F. Supp. 311 (S.D. Cal. 1951) and the "sweeping language" refers to the Court's statement that the Bank Board has promulgated regulations covering all aspects of every federal savings and loan association "from its cradle to its corporate grave." 98 F. Supp. 311, 316.

Mr. Russell's sentiments regarding local concerns echo those of the Chairman of the Bank Board during his testimony before Congress just prior to the enactment of the HOLA:

> "These associations will be federally chartered and the regulations as to how those things will be done are drawn by the board and put into effect. But they would be very careful, I should say. I know I would as a member of that board, *be very careful in authorizing them to do things that they were not authorized to do under state law. I do not think that would be our policy.*" Hearings on HOLA, H.R. 4980, House Comm. on Banking and Currency, 73rd Cong. 1st Sess. 23-24 (April 20, 1933) (statement of William F. Stevenson, Chairman, Federal Home Loan Bank Board) (emphasis added).

Federal relies.[31] In addition, that same General Counsel, and the Chairman of the Bank Board at the time that HOLA was enacted, are on record stating that federal associations must follow local matters, which include property transfers and secured transactions.[32]

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[31]See *Meyers v. Beverly Hills Federal S & L Ass'n.*, 499 F.2d 1145, 1146-1147 (9th Cir. 1974); *Kaski v. First Federal S & L Ass'n.*, 72 Wis. 2d 132, 136 (1976); *Kaski v. First Federal S & L Ass'n. of Boston v. Greenwald*, 591 F.2d 417, 425 (1st Cir. 1979); *Conference of Federal S & L Ass'ns. v. Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), aff'd. mem., 445 U.S. 921 (1980), all quoting the "cradle to grave" language in *People v. Coast Federal S & L Ass'n., supra.* Cf., *San Diego Building Trades Council v. Garmon, supra:*

> "In the course of a process of tentative, fragmentary illumination carried on over more than a decade during which the writers of opinions almost inevitably, because unconsciously, focus their primary attention on the facts of particular situations, language may have been used or views implied which do not completely harmonize with the clear pattern which the decisions have evolved." 359 U.S. 236, 244.

[32]Note also certain Congressional activity subsequent to the enactment of the HOLA:

> "*The Committee believes that federally chartered financial institutions should be subject to State consumer protection laws for the following reasons*:
>
> (1) *To safequard State's rights — Unless there are overriding interests to the contrary, the federal government should not interfere with the efforts of a State to protect consumers*. Federally chartered financial institutions are subject to a wide variety of State laws including laws dealing with taxes, branching, fire and building codes, conversions, usury and the like. The Committee sees no reason to make a special exception for consumer protection laws.
>
> (2) *To restrict unlimited administrative power* — Even if a case could be made for preempting a State consumer protection law in a particular area, *the power to reverse the judgment of a State should not be delegated to a federal administrative agency*. The Comptroller of the Currency and the National Credit Union Administration are headed by one man, while the Federal Home Loan Bank Board is headed by three. *These non-elected officials should not be given the power to overrule by a stroke of the pen, the considered judgment of a State Legislature and its Governor. Only congress should make such a decision if it is to be made at all . . .*" S. Rep. No. 93-902, 93rd Cong., 2d Sess. 12 (1974), reprinted in U.S. Code Cong. & Ad. News 6119, 6130-6131 (1974) (emphasis added).

It seems highly unlikely that in creating the federal associations to serve areas in which the existence of state-chartered institutions was inadequate, Congress intended to prohibit all state regulation of the newly created associations. In the absence of express Congressional direction, a contrary conclusion is repugnant to our federalist system.

3. The Language of the HOLA.

Congress can and does speak with clarity and forcefulness when preemption is desired;[33] but the language used by Congress in the HOLA *and* the language in Bank Board regulations promulgated shortly after the enactment of the HOLA indicate that Congress did *not* intend to displace local rules concerning property transfers and secured transactions.

Of course, loans extended by federally chartered associations had to be secured by mortgages or trust deeds. That the security documents employed by federal associations were to follow local contract and property laws is made clear in 12 U.S.C. §1461(c), as unamended.[34]

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[33]See *e.g.*, Senate Report No. 96-369 accompanying H.R. Bill 4986 (P.L. 96-221, March 31, 1980) preempting State usury restrictions. "[H.R. 4986] . . . would preempt any State constitutional or statutory provision setting a limit on mortgage interest rates. To allow states to establish or reestablish mortgage usury ceilings, the bill provides that states may override the preemption provisions if they adopt a new statutory mortgage interest ceiling within two years of the bill's enactment. *** In exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers." Senate Report No. 96-369 at 18, 19, reprinted in U.S. Code Cong. & Ad. News, No. 3, 852-853 (1980).

[34] "Sec. 2. As used in this Act . . . (c) The term 'home mortgage' means a first mortgage on real estate in fee simple or on a leasehold under a renewable lease for not less than ninety-nine years, upon which there is located a dwelling for not more than four families, used by the owner as a home or held by him as his homestead, and having a value not exceeding $20,000.00; and the term '*first mortgage' includes such classes of first liens as are commonly given to secure advances on real estate under the laws of the State in which the real estate is located, together with the credit instruments, if any, secured thereby.*" 12 U.S.C. §1461(c) (emphasis added).

The same deference to state law also appears in the definition of "home mortgage" in 24 C.F.R. §1.8 (1938), when Bank Board regulations were first published.[35]

Under 12 U.S.C. §1464(a), as unamended, the Bank Board was empowered to issue charters to allow qualified applicants to operate as federal savings and loan associations. The charter is the agreement between the Bank Board and the federal association defining the association's rights and obligations. T. Marvel, *The Federal Home Loan Bank Board*, 115-116 (1969). In 1936, the original charter was completely revised and Charter K was promulgated. Russell, *Savings and Loan Associations*, 67-69. It is significant that the Bank Board adhered to its policy of gearing loan documents to local contract and property laws. Thus, paragraph 14(b) of Charter K, which appears under 24 C.F.R. §202.9[36]

In addition to the foregoing, the Bank Board promulgated a regulation dealing specifically with the subject of "property transfers." 24 C.F.R. §402.05-22 (1938). (App. A, *infra*). This provision was revoked on August 17, 1938, and replaced by 24 C.F.R. §402.05-17 (1938 Supp.). (App. B, *infra*).

Section 402.05-22 (1938) appears in that part of the Bank Board regulations covering activities of the Loan Service

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[35]24 C.F.R. §1.8 (1938): "Home Mortgage. The term 'home mortgage' means a mortgage upon real estate, in fee simple, or on a leasehold . . . and shall include, in addition to first mortgages, such classes of first liens as are commonly given to secure advances on real estate by institutions authorized under the Act to become members, under the laws of the state in which the real estate is located, together with the credit instruments, if any, secured thereby." (Sec. 2 of FHLBA, as amended by Sec. 507, 48 Stat. 1264, Sec. 1, 49 Stat. 293; 12 U.S.C. 1422 and Supp.)

[36] "The primary obligation shall be secured by a mortgage or other instrument constituting a first lien or the full equivalent thereof upon the real estate securing the loan according to any lawful and well-recognized practice which is deemed best suited to the transaction. In keeping with the best loan practices in the territory, the instrument securing a loan on real estate shall provide for full protection to the association and shall be recorded."

Division of the HOLC. By purchasing existing mortgages in exchange for bonds, the HOLC amassed a sizeable loan portfolio. When property encumbered by a loan in the HOLC's portfolio was transferred, the agency did not exact an assumption fee and request an adjustment of the interest rate. Rather, the regulation indicates that the transferee would be accepted provided he could make the required loan payments and would agree to assume the existing obligation. This approach is similar to the creditworthiness/impairment test used in *Wellenkamp, supra.*[37]

The fact that the Bank Board was to "combine under Federal charter the best policies and practices developed in the savings and loan industry" (*West Helena Savings & Loan Association v. Federal Home Loan Bank Board,* 417 F. Supp. 220, 228 (E.D. Ark. 1976), aff'd 553 F.2d 1175 (9th Cir. 1977)) cannot reasonably be interpreted as expressing a congressional intent to preempt. The "best practices" language provides merely a standard to guide the Board's exercise of rule-making power.

Thus, the language of the HOLA and early Bank Board regulations themselves also contradict Fidelity Federal's assertion that Congress intended to oust state law in this matter. In fact, a careful review of the history, purpose and language of the HOLA clearly reveals that Congress intended to charter federal associations operating within the context of existing local rules governing property transfers and secured transactions.

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[37]The regulations of the Bank Board governing the operation of the federal associations also recognized, at least implicitly, that property which secured loans held by federal associations would be transferred subject to the loan. 24 C.F.R. §209.46 (1946), contained a discussion of Charter K, Section 4, dealing with "members." (App. C, *infra*). Subsection (b) (3) recognized property securing a federal association's loan would be transferred subject to the loan.

B. There Is No Need for National Uniformity in Real Property Law When a Federal Association Extends a Loan

The national uniformity ground for preemption is very narrowly limited to clearly and inherently national subjects such as immigration and interstate air travel. *Hines v. Davidowitz*, 312 U.S. 52 (1940) (immigration); *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624 (1973) (interstate air travel).[38] Even within the area of immigration, this Court has found room for state authority to regulate the employment of aliens not lawfully admitted to residence in the United States. *DeCanas v. Bica, supra.*

Three salient facts preclude a finding of need for national uniformity in the federal associations' due-on-sale enforcement.

First, in the almost fifty years since the enactment of the HOLA, and even in the six years since the due-on-sale issue became prominent, Congress has shown no indication whatsoever of its intent to preempt across the board. Yet this is precisely what would be expected if this area were "inherently national."[39]

Secondly, the Bank Board's due-on-sale regulation itself leaves to the associations individually the decisions of

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[38]In *Burbank*, the Court stressed the involvement of the Environmental Protection Agency (EPA) in the federal control of the aircraft noise problem. The Federal Aviation Administration was required to consult with the EPA prior to prescribing and amending regulations with respect to aircraft noise. 411 U.S. 629, 630. When the Bank Board passes regulations, on the other hand, there is no agency (analogous to the EPA in *Burbank*) with which the Bank Board must consult to ensure adequate representation of property owner's concerns: the Bank Board is not authorized or required by the HOLA to take such traditional state concerns into consideration. The Bank Board is headed by three non-elected officials. These considerations provoked the Court of Appeal's deep-rooted federalism concerns. (J.S. App. 15a-16a).

[39]See Appendix D, *infra*, containing a list of 49 cases where state laws were held applicable to conduct of federal associations in their relationships with borrowers.

whether to include and then, *if included, whether to enforce* the due-on-sale clause. The associations' discretion does not provide uniformity.[40]

The third interesting fact with respect to national uniformity of federal associations' due-on-sale enforcement involves Fidelity Federal's claim that California's due-on-sale law somehow interferes with the Federal Home Loan Mortgage Corporation's (FHLMC's) legislative mission to create a uniform secondary mortgage market. (Appellants' Brief, 31-35; see also Brief for the Bank Board and FHLMC as Amicus Curiae 25). Both the FHLMC and the Federal National Mortgage Association (FNMA) recognize that state law with respect to various terms of the loan documents will vary from state to state.[41]

Thus, the claimed need for uniformity with respect to federal associations' due-on-sale enforcement fails of its

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[40]Thus, the associations are not required to include the clause even for the purpose of protecting against transfer to an irresponsible grantee. Furthermore, although virtually all loan documents contain a due-on-sale clause, many federal associations enforce the clause only when the property is transferred to an irresponsible grantee.

[41]Since by its very design the FHLMC/FNMA instrument contains "non-uniform" covenants, the FHLMC and FNMA are required to make a separate analysis of each state's laws. As a practical matter, this is an insignificant burden because both agencies require the seller to service the loan. The FHLMC Seller's Guide requires the seller's warranty that all requirements of federal, *state and local law* applicable to mortgages and mortgage loan transactions have been complied with. (§§1.225; 1.409; 3.201(r); 4.201(r)). The FNMA Conventional Home Mortgage Selling Contract Supplement contains a similar warranty (§901.01). See also *Federal National Mortgage Ass'n. v. Lefkowitz*, 390 F. Supp. 1364 (S.D.N.Y. 1975) (FNMA bound by state law governing interest on impound accounts when it purchased a mortgage from a state institution).

Significantly, when the FHLMC purchases a loan in whole or in part, its policy is to enforce the due-on-sale clause *only when secured property is transferred to an irresponsible grantee*. Indeed, the FHLMC *prohibits any alteration of the interest rate* on loans purchased by it. This is also FNMA's policy with respect to loans originating prior to November 10, 1980. Moreover, when either of these agencies purchases only a percentage of a loan from a lender, the lender makes no representation to the agency that the lender will enforce the due-on-sale clause.

own force because the "uniformity" sought is not uniform at all: the lender's *option* to enforce the due-on-sale clause guarantees no uniform results. If the uniformity of due-on-sale enforcement by federal associations were indeed an important policy it would be better served by *mandating inclusion and enforcement* of such clauses.

C. California's Law Prohibiting Unreasonable Restraints on Alienation Does Not Conflict With the Relevant Federal Law

1. California's "Due-On-Sale Law" Does Not Conflict With the Objectives of the HOLA

This is not a case where the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." *Jones v. Rath Packing Co., supra,* 430 U.S. 526. Fidelity Federal stresses that the application of *Wellenkamp* to federal associations threatens the associations' economic viability.[42]

The suggestion is specious that any state law which adversely affects a federal association's profitability stands as an obstacle to the purpose of the HOLA. Nothing in the HOLA guarantees a federal association's profitability. Nothing in the HOLA indicates that Congress intended to insulate federal associations from the exigencies of market conditions. Fidelity Federal cannot rely on general statements of national policy. This Court, rejected a similar

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[42]It is the general economic situation which threatens the associations' viability, if it is threatened at all. Indeed, two bills are currently pending in Congress, designed to revamp the entire present delivery system of home mortgage financing. The bills, if enacted, would be titled the "Financial Institutions Restructuring Services Act of 1981" (S. 1720) and the "Thrift Institutions Restructuring Act of 1981" (S. 1703). Clearly, the financial crisis which all mortgage institutions face calls for Congress' attention and cannot be cured by a piecemeal, judicial slicing away of important state interests. Note also that among the provisions contained in S. 1720 is an invitation to Congress to preempt state due-on-sale law across the nation.

argument in *Commonwealth Edison Co. v. Montana, supra,* ____ U.S. ____, ____, 69 L.ed.2d 884, 905.

Clearly HOLA's primary purpose was to provide financing for home ownership. The federal associations are the vehicles for pursuing this goal.[43] The mere fact that Congress granted the Bank Board broad power to regulate the federal associations does not mean that legitimate state laws, which incidentally touch on the associations' profit picture, are obstacles to the HOLA which must be knocked down.[44] California's law preserving free mobility of title enhances the *choice* of property ownership, both as to whether to own property and which property to own. It is thus no obstacle to HOLA's goal of enhancing the availability of sources to finance the property purchase.

2. California's Due-On-Sale Law Does Not Conflict With the "Full Protection" Provision in the 1948 Regulation

Prior to June 8, 1976, no federal law mentioned the due-on-sale clause. However, a regulation in existence since 1948 required loan documents used by federal associations to provide for full protection to the federal associations. 12 C.F.R. §545.6-11(a) (now codified at 12 C.F.R. §545.8-3(a)).

In 1975, the Bank Board submitted its interpretation of the "full protection" language contained in the 1948 regulation. Federal Home Loan Bank Board Resolution No. 75-647 (July 30, 1975). The resolution was rendered in the form of an advisory opinion at the request of the Court in a case entitled *Schott v. Mission Federal Savings and Loan*

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[43]It would be "unreasonable, and ironic, to hold now that the Congress intended [the act] to justify the removal of homeowners' protections under state law." *Holiday Acres v. Midwest Federal Savings & Loan Ass'n.*, 308 N.W.2d 471, 476 (Minn. Supr. Ct. 1981).

[44]Zoning laws, building codes, workers' compensation laws, anti-deficiency laws, proceedings for foreclosure, redemption laws, and rent control ordinances all impose costs on the associations.

Association (D.C. Cal.) (Case No. CIV-75-366 WMB). The Bank Board found that federal law preempts state due-on-sale law based on a purported congressional intent to occupy the entire field touching federal associations; the Board also concluded that state law was preempted based on the "full protection" language of the 1948 regulation.

Resolution No. 75-647 (the "Schott Advisory Opinion") interprets the "full protection" language in the 1948 regulation as authorizing the federal associations' automatic enforcement of the due-on-sale clauses. This interpretation is based on the Bank Board's decision in 1975 that automatic due-on-sale enforcement is necessary to the economic well-being of the federal associations. Schott Advisory Opinion, 17-37.

The Bank Board's interpretation of "full protection" is textually unsupported; it is plausible only by taking the language out of context and viewing it in the abstract. The Bank Board seizes two words to support its position, but ignores the remainder of the regulation. The "full protection" language must be read in context.[45]

It is significant that each of the required provisions — protection with respect to insurance, taxes and maintenance — protects the federal association's security interest. These are typical examples of "collateral obligations." These ob-

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[45] "(a) Required and authorized provisions. Each loan shall be evidenced by note, bond or other instrument and shall be secured by such security instrument as is in keeping with sound lending practices. The loan contract shall provide for full protection to the Federal association in accordance with applicable provisions of the Federal association's charter and bylaws. It shall be recorded and, among other protections, *it shall provide specifically for full protection with respect to insurance, taxes, assessments, other governmental levies, maintenance, and repairs.* It may provide for an assignment of rents. Such Federal association may pay taxes, assessments, insurance premiums, and other similar charges for the protection of its interest in the property on which it has loans; . . ." 12 C.F.R. §545.6-11(a) (now codified at 12 C.F.R. §545.8-3(a)) (emphasis added).

ligations, as the regulation indicates, impose duties on the trustor and also permit the beneficiary to perform the obligations if the trustor does not.[46]

It is also interesting that the "full protection" referred to in the 1948 regulation refers to the protection afforded the association by *local law*.[47] Thus, read in full context, "full protection" cannot be stretched to authorize exemption from local laws merely because it is advantageous to do so. "Full protection" merely authorizes the inclusion of provisions commonly placed in loan documents to protect the lender's secured interest, *i.e.*, that interest which is already secured, not an uncalculated prospective economic interest.

California's due-on-sale law is not repugnant to the full protection language. California's law authorizes the due-on-sale clause to be included in loan documents, and authorizes enforcement of the clause when the lender's security interest is threatened. Clearly, this protection of the lender's security interest is harmonious with the "full protection" of the 1948 regulation. The Bank Board's 1975 interpretation of "full protection" under the 1948 regulation is not a "long-standing, contemporaneous construction" of a statute, entitled to great deference. *Leary v. United States*, 395 U.S. 6, 25 (1969). The timeliness of the Bank Board's interpre-

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[46]These obligations serve only to protect the lender's secured position. For instance, a federal association has no abstract interest in ensuring that its trustors pay their local property taxes. An association's only interest is to protect its secured position from loss at a forced tax lien sale. The regulation recognizes this interest by authorizing a federal association to pay taxes "for the protection of its interest in the property on which it has loans." Similarly, the federal association's only interest in ensuring that the trustor maintains the property is to ensure the value of the property is sufficient to discharge the unpaid balance of the debt in the event of default. The only utility to the beneficiary in requiring that the trustor insure the property is to provide a fund sufficient to discharge the indebtedness in the event the property is destroyed.

[47]See *Johnson v. First Federal Savings and Loan Association*, 418 F. Supp. 1106, 1109 (E.D. Mich. 1976) (112 C.F.R. §545.6-11(a)) incorporates by reference state law in the several jurisdictions).

tation is also relevant. The interpretation's credibility suffers because it was made when the Bank Board had intervened as an interested party in a lawsuit. *Batterton v. Francis*, 432 U.S. 416 (1977). In any event, a federal agency may not, under the guise of interpretation, expand or restrict the operation of a federal statute. *U.S. v. Colamaro*, 354 U.S. 351 (1957); *Neuberger v. Commissioner*, 311 U.S. 83 (1940).

3. California's Due-On-Sale Law Does Not Conflict With the 1976 Regulation

After the Bank Board issued the Schott Advisory Opinion, it then promulgated an actual due-on-sale regulation. 12 C.F.R. §545.6-11(f) (June 8, 1976) (now codified at 12 C.F.R. §545.8-3(f)).[48]

As a preliminary matter, the regulation is not applicable to the deeds of trust in the *Whitcombe* or *de la Cuesta* cases. Both deeds of trust were executed years before the regulation was promulgated.[49]

It is a well-established principle of law that a statute or regulation cannot be applied retroactively unless it clearly states otherwise, *e.g., Greene v. United States*, 376 U.S. 149 (1964). In promulgating the due-on-sale regulation, the Bank Board did not clearly and unambiguously express an intent that the regulation apply to loans executed earlier. That the federal associations "continue to have the power to include" the clause in their loan documents is insufficient evidence of retroactive intent. (See 12 C.F.R. §545.8-3(f)).

In any event, the Court of Appeal correctly followed controlling precedent in determining that California Civil

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[48]By its own terms the regulation was not effective until July 31, 1976. (See Federal Home Loan Bank Board Resolution No. 76-296, J.S. App. 44a).

[49]The deed of trust involved in *Whitcombe* was executed by the trustors on July 17, 1972 (J.A. 84-85, 93). The deed of trust involved in *de la Cuesta* was executed by the trustors on January 18, 1971 (J.A. 5-6, 14).

Code §711, and its case law progeny, does not conflict with the due-on-sale regulation. The Court of Appeal found no conflict because it is possible for federal associations to comply with both state and federal law, relying on this Court's decision in *Florida Lime and Avocado Growers, Inc. v. Paul, supra.*

In *Goldstein v. California*, 412 U.S. 546 (1973), this Court held that state legislation, to be preempted, must be "absolutely and totally contradictory and repugnant" to the federal law. *Id.*, 553. California's law prohibiting unreasonable restraints on alienation cannot be characterized as such. The due-on-sale regulation merely authorizes the option to include the clause, and then goes on to describe a due-on-sale clause.[50]

The regulation does not empower the federal associations to automatically enforce a due-on-sale clause regardless of other provisions of law.[51] The associations are merely au-

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[50] "A Federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. Except [as to limitation in Subsection (g) hereunder] exercise by an association of such an acceleration option (hereafter called a due-on-sale clause) shall be governed exclusively by the terms of the contract between the association and the borrower, and all rights and remedies of the association and borrower thereto shall be fixed and governed by said contract." 12 C.F.R. §545.8-3(f).

[51] Subsection (g) of the regulation places some limitations on exercise of the clause; the only "limitation" relevant in these cases is subsection (g)(3) which states that the association shall have waived the option to exercise the clause if the association reaches an agreement with a transferee to pay interest on the loan "at such rate as the association shall request." Absent such an "agreement," of course, the association purportedly has the right to accelerate the debt and sell the property through California's foreclosure proceedings. "Agreement" will not be reached when the transferee simply cannot afford monthly payments with interest charged at the association's unbridled discretion. See *Crispis v. Glen-*

(footnote continued on following page)

thorized to include the clause in their loan documents *as a matter of contract*.

The regulation leaves the rights and remedies of the parties intact under the terms of the loan contract. The interpretation and enforcement of contracts is, of course, traditionally governed by state law. *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979).[52] The "invalidation of contract clauses held repugnant to state policy is a proper exercise of the state judicial function." *Mariniella v. Shell Oil Co.*, 511 F.2d 853, 858 (3rd Cir. 1975).

The mere fact that federal law permits the use of a due-on-sale clause does not necessarily mean that any state law which places reasonableness limitations on its use is invalid.[53] In *Jones v. Rath Packing, supra*, this Court reasoned that a state statute is not inconsistent with a federal enactment when it is possible to comply with both the state and federal rules without triggering federal enforcement action. 430 U.S. 519, 540.

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dale Federal Sav. & Loan Ass'n, pending in the Superior Court of the State of California, County of Orange (Case No. CW 17422), wherein the transferee could not afford the association's assumption offer. In opposition to the transferee's application for injunction pending appeal, Glendale Federal stated that "the proposed foreclosure sale of the subject real property [the transferee's home] would merely result in the conversion of the within action to one for damages." (Memorandum of Points and Authorities in Opposition to "Ex Parte Application for Injunction Pending Appeal, etc.", 5 fn. 5). Clearly Glendale Federal did not heed the Bank Board's admonishment to consider waiving the purported right to require an increase in interest rate in case of extreme hardship. Federal Home Loan Bank Board Resolution No. 76-296 (April 28, 1976) §556.9(c) (J.S. App. 43a, 49a).

[52]See *DeSimone v. Warwick Federal S&L Ass'n*, 482 F. Supp. 1190 (D.R.I. 1980) (the Bank Board regulation regarding late charges, 12 C.F.R. §545.8-3(d), containing language identical to the due-on-sale regulation, "seems to indicate a strong intent to leave late charges to the contract, and not to detailed federal supervision.") *Id.*, 1193.

[53]For example, a state statute prohibiting the use of real property as security for a pre-existing debt is applicable to national banks even though federal law specifically allows national banks to use real property as security for pre-existing debts. *McClellan v. Chipman*, 164 U.S. 347 (1896). Cf., *Huron Portland Cement Co. v. Detroit*, 362 U.S. 440, 444-447 (1960).

In the glaring absence of a conflict herein, Fidelity Federal attempts to supplement its claim of preemption by constant reference to the board regulatory power of the Bank Board,[54] and the Bank Board's intent to preempt. A federal agency has never been allowed to preempt, by fiat, state law in areas of traditional local concern. A showing of conflict between the Bank Board regulation and California's due-on-sale law is necessary. Preemption by administrative fiat would profoundly offend the notions of federal-state comity, and would seriously disrupt the balance of federalism.

If Congress intends to exclude even harmonious state regulation, any attempt by a federal agency to accomplish this same goal is superfluous. If Congress does not intend to exclude even harmonious state regulations, any attempt by a federal agency to do so is beyond its power. The Court

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[54]Despite the Bank Board's assertions that there is no mention in the HOLA or its history of limitations on the Board's power to regulate the federal associations (Brief of the Bank Board as *Amicus Curiae*, 11-14), there are limitations even as to the Bank Board's "internal" management of the associations.

In 1975, the Bank Board proposed a regulation authorizing the associations to offer variable interest rate mortgages (VRMs) to borrowers. The Senate's response:

> "[T]hat it is the sense of the Congress that the Federal Home Loan Bank Board shall refrain from authorizing, by rule, regulation, or otherwise, a federal savings and loan association to offer loans with variable interest rates and secured by one to four family homes or dwelling units unless Congress specifically, by law, authorizes such variable interest rates." S.Con.Res. 45, 94th Cong., 1st Sess. (June 17, 1975).

The Bank Board then withdrew the VRM proposal. It was not until 1979 that the Bank Board was given the power to authorize VRMs, in an informal consent by the House of Representatives indicating that Congress would no longer restrain a VRM regulation. House Committee Hearings on Consumer Checking Account Equity Act of 1979, Hearings before Subcommittee on Banking Finance and Urban Affairs, 96th Cong., 1st Sess. 110 (May 16, 1979) (H.R. 3864). The Bank Board promulgated regulations authorizing VRMs for the associations. 12 C.F.R. §§545.14; 545.6-4(c) (1980). Note that this eliminated one of the Bank Board's stated reasons as to why automatic due-on-sale enforcement was necessary for the federal associations. (Schott Advisory Opinion).

of Appeal correctly observed the difference between regulatory agency enactments and the necessary congressional intent to preempt. (J.S.App. 15a-16a).[55]

It should also be noted that the Bank Board has not even attempted to regulate in the areas of real property and mortgages. The Bank Board has not regulated recording requirements, foreclosure proceedings, deficiency judgments, lien priorities, rights of redemption and the like. As the Court of Appeal pointed out, federal associations have always been governed by state real property and mortgage law (J.S. 11a-12a). The HOLA and the regulations promulgated thereunder, far from being comprehensive, are nonexistent in the areas of real property and mortgages. The Court of Appeal's internal/external distinction gives effect to these considerations. Fidelity Federal has not cited, and appellees have not discovered, a single decision rejecting the internal/external distinction.[56]

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[55]The holding in *United States v. Shimer*, 367 U.S. 374 (1961) is not to the contrary. This Court phrased the question presented as whether "the application of state law to determine the Administration's obligation to Excelsior is *inconsistent* with the Regulations prescribed by the agency charged with administering the Servicemen's Readjustment Act." *Id.*, 377 (emphasis added). This Court was not presented with the question of whether the application of state law not inconsistent with federal regulations was permissible. Moreover, the language regarding the agency's intent in *Shimer* is phrased in terms of whether the *agency* (the Veterans Administration) itself intended to submit to state law. There is no question in these cases regarding the Bank Board's submission to state regulation, and the federal associations are not federal agencies.

[56]In *People v. Coast Federal Sav. and Loan Ass'n, supra*, the court held that certain provisions of the California banking laws were preempted. The court was faced with an attempt by a state to meddle in the "internal" affairs of a federal association. The opinion clearly indicates that this is what concerned the court. For instance, the court noted that "[n]o provision is made for sharing the Board's delegated authority with *state regulatory or supervising agencies*." 98 F. Supp. 311, 316 (emphasis added).

In *City Federal Savings and Loan Association v. Crowley*, 393 F. Supp. 644 (E.D. Wis. 1975), the court stated:

> "The exclusivity of federal law means that when state courts 'deal with the internal affairs of federal savings and loan associations

Conference of Federal Savings and Loan Associations v. Stein, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980), provides Fidelity Federal no solace. Under the provisions of the state redlining act, the Secretary was given power to monitor and investigate alleged violations, and to

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. . . they are nonetheless applying federal law.' [citing *Murphy v. Colonial Federal Savings and Loan Association*, 388 F.2d 609, 612 (2nd Cir. 1967)]." 393 F. Supp. 644, 655.

The court in *City Federal* did not hold that all the activities of federal associations are governed by federal law. In distinguishing certain decisions the court noted that "it is not obvious that the issue of whether a federal savings and loan association has fiduciary duties to its borrowers is one dealing with the internal affairs of the association." *Id.*, 656.

In rejecting a claim that purely contractual matters were governed by federal law, the court in *DeSimone v. Warwick Federal Sav. and Loan Ass'n, supra*, refused to extend *City Federal* to areas not involving the internal affairs, noting that "the Court [in *City Federal*] repeatedly stressed that the issue involved the *internal* affairs of the federal savings and loan association. In fact, the Court in *City* specifically distinguished fiduciary duties to borrowers (at issue in the present suit) from issues of internal management (at issue in *City*)." *Id.*, 1194 (emphasis in original).

In *Rettig v. Arlington Heights Federal Sav. and Loan Ass'n*, 405 F.Supp. 819, 823 (N.D. Ill. 1935), the court recognized the internal affairs distinction. *Rettig* was distinguished in the same manner as *City Federal* by the court in *DeSimone, supra*, 482 F. Supp. 1190, 1194.

In *Murphy v. Colonial Federal Sav. and Loan Ass'n*, 388 F.2d 609, 612 (2nd Cir. 1967), the court explicitly recognized the internal affairs distinction.

In *Kupiec v. Republic Federal Sav. and Loan Ass'n*, 512 F.2d 147, 149 (7th Cir. 1975), the issues involved the means of communication between members of the association, not issues of state real property and mortgage law.

In *Lyons Sav. and Loan Ass'n v. Federal Home Loan Bank Board*, 377 F. Supp. 11, 14, (N.D. Ill. 1974), the issues involved establishment of branch offices, not state real property and mortgage law.

In *North Arlington National Bank v. Kearny Federal Sav. and Loan Ass'n*, 187 F.2d 564 (3rd Cir. 1951), the issues involved establishment of branch offices, not state real property and mortgage law.

In *Central Sav. and Loan Ass'n of Chariton, Iowa v. Federal Home Loan Bank Board*, 422 F.2d 504, 505 (8th Cir. 1970), the issues involved utilization of a mobile savings and loan facility, not state real property and mortgage law.

In *Springfield Institution v. Worcester Federal Sav. and Loan Ass'n*, 107 N.E.2d 315, 316 (Mass. 1952), the issues involved establishment of branch offices, not state real property and mortgage law.

In *Washington Federal Sav. and Loan Ass'n of Miami Beach v.*

(footnote continued on following page)

issue cease and desist orders. *Id.*, 1259. These provisions were held preempted. The court specifically noted that "we are not faced with a suit by a borrower against a federal association charging a violation of a substantive state regulation." *Id.*, 1260.[57]

More recently, in *Gulf Federal Savings and Loan Association v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir. 1981), the Bank Board attempted to issue a cease and desist order against a federal association for conducting "unsound lending practices" and for "violations of law." The court found that the disputed loan agreement provision used by Gulf Federal, termed a lending practice by the Bank Board, was a part of the contract between the association and its borrower, and had nothing to do with the internal management of the association. *Id.*, 266.[58]

Balaban, 281 So.2d 15, 16 (Fla. 1973), the issues involved a state's power to enjoin a federal association from participating in hearings conducted by the Federal Home Loan Bank Board held in connection with an application by a federal association to establish a branch office, not state real property and mortgage law.

In *Sears v. First Federal Sav. and Loan Ass'n of Chicago*, 275 N.E.2d 300 (Ill. 1971), the result did not even turn on a question of federal law. The court determined as a matter of *state contract law* that the provision in the note and trust deed for advance payments of taxes, assessments, and insurance premiums did not establish a trust. In partial support of this result the court pointed to 12 C.F.R. §545.6-11, governing such advance payments. *Id.*, 308. The Court specifically refrained from deciding the federal association's claims, *inter alia*, that federal regulations do not permit payment of interest or earnings on such advance payments. *Id.*, 309.

In *First Federal Sav. and Loan Ass'n of Boston v. Greenwald*, 591 F.2d 417, 425-426 (1st Cir. 1979), the court found a conflict between state law and federal law and specifically declined to express an opinion as to the claim that federal law occupies the field.

[57]See the Senate's observation of the *Stein* case (App. E, *infra*).

[58]Note the Bank Board's indifference to federalism concerns in the court's opinion: "The Board concluded that state law and federal law were equivalent, and that it was not necessary to determine which law applied to Gulf Federal's conduct." *Id.* Note also the irony of Gulf Federal's claim that the Bank Board was using its authority improperly, in an attempt to enter the consumer protection field. *Id.*, 261.

The internal/external distinction places the federal and state spheres of authority in the proper perspective.[59] The states may not regulate the internal, business affairs of the federal associations. Conversely, the Bank Board may not, through implicit administrative design, effectively preempt state law on state matters.[60] In this case, there is no "actual conflict between the two schemes that they both cannot stand in the same area." *Florida Lime and Avocado Growers, Inc. v. Paul, supra,* 279 U.S. 41.

This Court should not seek out conflicts where none clearly exist, *Huron Portland Cement Co., supra,* 362 U.S. 446, but should seek to reconcile the operation of the state and federal statutory schemes. *Merrill Lynch, Pierce, Fen-*

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[59]Fidelity Federal suggests that the Court of Appeal was mistaken in its reliance on *Florida Lime and Avocado Growers, Inc., supra,* and that the Court of Appeal should have followed *Meyers v. Beverly Hills Federal Sav. & Loan Ass'n.,* 499 F.2d 1145 (9th Cir. 1974). However, in a more recent case the Ninth Circuit employed reasoning analogous to the Court of Appeal. In *Credit Data of Arizona, Inc. v. State of Arizona,* 602 F.2d 195 (9th Cir. 1979), the court upheld the application of a state law prohibiting a credit agency from imposing a fee for disclosing its sources of credit information, even though the federal Fair Credit Reporting Act explicitly permitted such a charge. *Id.,* 198. In reaching this result, the court in *Credit Data* relied upon this Court's reasoning in *Jones v. Rath Packing Co., supra.*

[60]Compare Florida's approach to the issue. The federal lenders there must follow judicial foreclosure proceedings to enforce the due-on-sale clause. The court, sitting in equity, refuses to grant the foreclosure based on traditional equitable principles. *First Federal Sav. & Loan Ass'n of Englewood v. Lockwood,* 385 So.2d 156 (Ct.App. Fla. 1980). Under federal law, the traditional remedies of a court of equity are not circumscribed unless a statute mandates it. *Porter v. Warner Holding Company,* 328 U.S. 395, 398 (1945). For other states' approaches see *Patton v. First Federal Sav. & Loan Ass'n of Phoenix,* 118 Ariz. 473 (1978); *Nichols v. Ann Arbor Federal Sav. & Loan Ass'n,* 73 Mich.App. 163, leave to appeal denied, 400 Mich. 844 (1977); *Continental Federal Sav. & Loan Ass'n v. Fetter,* 564 P.2d 1013 (Okl. 1977); *First Southern Federal Sav. & Loan Ass'n of Mobile v. Britton,* 345 So.2d 300 (Ala. Civ. App. 1977); *Bellingham First Federal Sav. & Loan Ass'n v. Garrison,* 87 Wash.2d 437 (1976); *Mutual Federal Sav. & Loan Ass'n v. American Medical Services,* 66 Wis.2d 210 (1974); *Tucker v. Pulaski Federal Sav. & Loan Ass'n,* 252 Ark. 849 (1972).

ner & Smith v. Ware, supra, 414 U.S. 127. A mere possibility of conflict or a hypothetical conflict is insufficient to invalidate legitimate state laws.

III.

FIDELITY FEDERAL'S DEEDS OF TRUST SHOW A CLEAR AND UNMISTAKABLE INTENT TO BE BOUND BY CALIFORNIA REAL PROPERTY LAW

A. Fidelity Federal and Federal Home Loan Bank Board Use and Approve the Subject Deeds of Trust

A careful review of the deeds of trust in the *de la Cuesta, Moore* and *Whitcombe* cases demonstrates Fidelity Federal's voluntary and complete submission to California real property and mortgage law.

Fidelity Federal is solely responsible for the content and language of the deeds of trust. Fidelity Federal uses standardized deeds of trust. The deeds of trust were presented to the borrowers without any change in the provisions.

In addition to Fidelity Federal's review of the documents, the Federal Home Loan Bank Board also reviews the loan documents.[61] Therefore, both Fidelity Federal and the Federal Home Loan Bank Board must be charged with full knowledge of the contents of the deeds of trust and the application of state law.

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[61]Resolution 75-647 of the Federal Home Loan Bank Board states: "[T]he Board's staff . . . conduct(s) annual examinations of Federal Associations pursuant to this agency's statutory authority under 12 U.S.C. 1726(b) and 1730(m)(1) and (2). *An essential part of each examination is an inspection of the loan documents being used by Federal Associations*." (Emphasis added.)

B. The General Provisions of the Deed of Trust Refer Solely to California Law

It is apparent that Fidelity Federal fully understood the applicability of California law. The subject deeds of trust contain numerous references to the applicable law and, in several instances, refer specifically to California law.[62]

Whether general or specific, all of the references involve some aspect of California law. No references are made to federal law or the regulations of the Federal Home Loan Bank Board in any of the deeds of trust.

C. The Inclusion of a "Law of the Jurisdiction" Clause Shows Unequivocal Intent to Be Bound by State Law

In the deeds of trust in *Moore* and *Whitcombe*[63] cases, Fidelity Federal has included the following provision:

> "This deed of trust shall be governed by the law of the jurisdiction where the Property is located."

Appellees assert that the inclusion of this provision provides clear evidence that Fidelity Federal not only recog-

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[62]General references to the applicable law are found in the *de la Cuesta* deed of trust at J.A. 20, 26, 27, 30, 31, 33. Specific references are found at J.A. 17 (Calif. Civ. Code §2943) and J.A. 18 ("In the event of the passage after the date of this Deed of Trust of any law of the State of California . . . or changing in any way the laws of taxation of deeds of trust . . . for state or local purposes . . . so as to affect this Deed of Trust").

General references to the applicable law are found in the *Moore* deed of trust at J.A. 59, 60, 65, 66, 67 (several references), 68, 69, 70 (several references), 72, 73. Specific reference to California law is found at J.A. 72 (Section 2943 of the Civil Code of California).

General references to the applicable law are found in the *Whitcombe* deed of trust at J.A. 98, 99, 102, 104, 105 (several references), 106, 108, 110 (several references), 112. Specific references are found at J.A. 96 (Calif. Civ. Code §2943) and J.A. 96-97 ("In the event of the passage after the date of this Deed of Trust of any laws of the State of California . . . or changing in any way the laws of taxation of deeds of trust . . . for state or local purposes . . . so as to affect this Deed of Trust").

[63]See footnote 2, *supra*.

nized the applicability of state law, but contractually bound itself to follow state law.[64]

The Court below found it unnecessary to rely solely upon this ground as a basis for its holding. However, the Court did recognize that the "general use of the provision containing such language by federal savings and loan associations with the approval of the Board persuasively evidences a recognition by the Board and federal savings and loan associations that state law would govern the interpretation, validity, and enforcement of security instruments." J.S. App. 23a-24a.

The Court's discussion and interpretation of the "law of the jurisdiction" was supportive and partially decisive in its determination that California law was controlling.

An analysis of the preemption question, with full consideration of the effect of a "law of jurisdiction" clause, demonstrates that no preemption exists in the within appeal.

D. Fidelity Federal Contracted to Follow State Law as to Its Due-On-Sale Enforcement by Inclusion of a "Law of Jurisdiction" Clause

Appellees agree with Fidelity Federal that the "law of the jurisdiction" provision necessarily includes not only California law, but federal law which is preemptive. *Hauen-*

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[64]Note the counterpart in California Federal Sav. and Loan Association's deeds of trust: "LAW OF CALIFORNIA CONTROLLING: This deed shall be construed according to the laws of the State of California." A clearer expression of intent to be bound by California law is hard to imagine. This provision is present in the cases of *California Federal Savings & Loan Association v. Tan, California Federal Savings & Loan Association v. Romagnoli, California Federal Savings & Loan Association v. Ben, California Federal Savings & Loan Association v. Dunn, California Federal Savings & Loan Association v. Renner* (Consolidated Appeals pending in this Court, Case No. 81-993). The "law of the jurisdiction" clause is also contained in the deeds of trust in other two cases before this Court. See *Pan American Savings & Loan Association v. Stanley E. Panko, et al.*, Case No. 81-922 and *California Federal Savings & Loan Association v. Hanlon*, Case No. 81-993.

stein v. Lynham, 100 U.S. 483 (1880). However, Fidelity Federal incorrectly *assumes* preemption of due-on-sale enforcement *before* analyzing the effect of the provision. Appellants' Brief 32-33.

Absent a pre-determined conclusion of preemption, a critical analysis of the provision focuses on two questions:

1. Does California law require Fidelity Federal to do some act *prohibited* by federal law?

2. Does California law prohibit Fidelity Federal from doing some act *required* by federal law?

To answer these questions a review of the applicable regulation, 12 C.F.R. §545.8(f) and (g), is necessary. See page 35, *supra*.

The literal language of the regulation reveals that the association has the *option* to include a due-on-sale provision in the contract. It clearly does not *mandate* the inclusion of the provision.

Further, the regulation does not mandate the association to exercise the due-on-sale provision, once the provision is included. Instead, it leaves the entire matter to be governed *exclusively* by the terms of the loan contract. It does not say that the exercise of the clause is governed by federal law.

How, then, is the contract to be interpreted? The contract itself contains a clause specifying the law which governs interpretation of the contract, *i.e.*, the "law of the jurisdiction." Obviously, California law is the law of the jurisdiction where the property is located.

Against this background, the two critical questions can easily be answered. First, California due-on-sale law does not require Fidelity Federal to do some act which is prohibited by the regulation: The regulation does not prohibit the associations from using a reasonable standard in their due-on-sale enforcement. The associations are allowed to limit their enforcement to situations where the secured prop-

erty is transferred to an irresponsible grantee, as required under California law.

Conversely, California's due-on-sale law does not prohibit Fidelity Federal from doing some act which is *required* by federal law. There is no required act under the federal law. In any event, California's law certainly does not prohibit the inclusion of a due-on-sale clause. The association's power to include the clause remains untouched by the California law. Once the clause is included, California law does not prohibit enforcement of a due-on-sale clause, it merely requires a reasonableness standard for enforcement.

It is important to note that the Bank Board could have easily enacted a regulation stating that federal law exclusively applies to certain terms in the loan documents of federal associations. *United States v. Gish*, 559 F.2d 572 (9th Cir. 1977). The borrower would then be notified that the due-on-sale clause might be enforced for reasons other than security protection.[65] Furthermore, Fidelity Federal could easily have drafted the subject "law of the jurisdiction" clause to provide:

> "This Deed of Trust shall be governed by the law of the jurisdiction in which the property is located, except

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[65]See Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 Iowa L.Rev. 747, 799 (1973):

> "[T]he due-on-sale clause, even if read by the borrower, certainly does not convey the notion that waiver fees might be exacted or a higher interest rate demanded if the borrower dares to sell his property. Insofar as the due-on-sale clause would be justified as a disguised variable-rate mortgage, the fact remains that the element of disclosure is lacking."

See also, Professor Allison's testimony at the Federal National Mortgage Association Public Meeting on Conventional Mortgage Forms (April 6-April 7, 1971), p. 92:

> "If the purpose of the [due-on-sale] clause is to give the lender the power to obtain a higher interest rate, it is deceptive since it does not communicate to the borrower or his successor that they are expected to buy the lender's consent by renegotiating the mortgage at the current market rates."

where certain federal law or regulations of the Federal Home Loan Bank Board governs."

In *United States v. Gish, supra,* the Small Business Administration was allowed to recover deficiency judgments after foreclosure *precisely because administrative regulations and contractual terms in the loan documents provided that state law did not apply.* By not taking the simple step of ensuring that federal law governs certain terms of the subject trust deed, Fidelity Federal cannot complain that the "law of the jurisdiction" provision does not mean that California law is controlling.

E. Federal Common Law Permits the Federal Associations to Contract to Follow State Law

Numerous cases recognize that even federal instrumentalities can agree to be bound by state law.[66]

The matter at hand bears a strong similarity to *United States v. Yazell,* 382 U.S. 341 (1966). In *Yazell,* the Court emphasized the fact that the disaster loan contract held by the Small Business Administration (SBA) was individually negotiated and did not contain a waiver of the Texas law of coverture. The SBA was denied certain benefits which would violate the state law of coverture. In the instant case, the loan document, albeit an adhesion contract (see Section F, *infra*), was individually signed and contains a provision which specifically states that each provision of the trust deed shall be governed by California law. In *Yazell,* the Court also noted that the subject matter involved, family property and the protection of married women, covered "intensely local interests."

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[66]It should be noted that federal savings and loans are "wholly private" business organizations and are *not* federal instrumentalities in any sense. *Gibson v. First Federal Sav. & Loan Assn.,* 347 F. Supp. 560, 563 (E.D. Mich. 1972); *Midwest Federal Sav. & Loan Assn. v. Commissioner of Revenue,* 259 N.W.2d 596 (Minn. 1977), at p. 598. If federal instrumentalities can bind themselves to follow state law, certainly wholly private business corporations can do the same.

In this case, the subject matter involves a loan contract and a transfer of real property, which are also intensely local concerns. In *Yazell*, the Court ruled that the state's interest in regulating family property outweighed the federal government's concern in collecting debts.[67]

The fact that even federal agencies can obligate themselves to abide by state law was also recognized in *Dalton Motors, Inc. v. Weaver*, 446 F. Supp. 711, 714 (D. Minn. 1978) ("Quite apart from considerations of federalism, a federal agency and an individual with whom it contracts may agree that state or federal law is to govern their relationship.").

In *DeSimone v. Warwick Federal Sav. & Loan Ass'n, supra*, the plaintiffs sued Warwick Federal, *inter alia*, for an alleged violation of the Bank Board's late charges regulation, 12 C.F.R. §545.6-11(d), now recodified at §545.8-3(d). This late charge regulation is quite similar to the due-on-sale regulation, 12 C.F.R. §545.8-3(f), because collection of late charges, like enforcement of the due-on-sale clause, is expressly governed by the terms of the loan contract.

The court's comments regarding the "contract" language in 12 C.F.R. §545.6-11(d) are significant:

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[67]In *Kirkland v. Fidelity Federal Savings and Loan Association of Jacksonville*, 79-859-J-B (M.D. Fla. 1980), the lender's claim of federal subject matter jurisdiction was rejected in a due-on-sale case. The court also recognized the problem in interpreting the "law of the jurisdiction" provision:

> "Even if [the provision does not refer to state law], the court would almost be forced to look to state law. There is no federal law governing the interpretation of mortgages. *Defendant's position would require the Court to fashion an entire body of federal law to govern real estate mortgages.*" (Emphasis added.)

The court was unwilling to undertake this task without explicit congressional direction. The court recognized that a mere delegation of rule-making authority to the Bank Board does not constitute a direction to the Bank Board or the courts to establish a body of federal mortgage law.

> "The Court has been unable to find any consideration of this regulation by other courts, and it is not easy to interpret it. Taken as a whole, *the regulation seems to indicate a strong intent to leave late charges to the contract,* and not to detailed federal supervision." (Emphasis added.)

The same interpretation should be given to the due-on-sale regulation. The regulation states specifically that enforcement of the due-on-sale clause is a matter of contract. The subject trust deeds, in turn, expressly provide that the provisions in said deeds shall be governed by California law.[68]

Significantly, there is nothing in the HOLA or the Bank Board regulations which covers the effect of a "law of the jurisdiction" or "California law" provision in the terms of loan documents executed by federal associations. In the *Schott Advisory Opinion* the Bank Board sets forth its position on how to resolve such a controversy.[69]

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[68]See also *United States v. MacKenzie*, 510 F.2d 39 (9th Cir. 1975), where the Small Business Administration attempted to avoid state laws concerning anti-deficiency judgments and redemption rights after foreclosing on two different loans. The loan document *involved specified that the loan was to be governed by the law of the state in which the secured real property was located,* 510 F.2d at 43. Thus the Court allowed the contract terms and state law to prevail. See also *United States v. Stewart*, 523 F.2d 1070 (9th Cir. 1975), where the Veterans Administration ("VA") made a loan for the purchase of a home and took back a promissory note and trust deed as security. The note and trust deed, like the subject loan documents herein, contained a provision which stated that the terms of the loan documents were to be governed according to the laws of California. When the trustor defaulted, the VA proceeded with a non-judicial foreclosure with a subsequent attempt to obtain a deficiency judgment which is prohibited in California on purchase money mortgages under C.C.P. §580(b), (d). The Ninth Circuit denied the granting of a deficiency in violation of state law.

[69] "(T)o the extent that there may be gaps in the general subject matter encompassed by the Board's regulations, they must be 'fleshed out' by Federal law in one of two ways. The Board may close the 'gap' by the promulgation of additional regulations, the Adoption of Board Rulings or Policy Statements, or by the issuance of interpretive opinions such as this Advisory Opinion. Alternatively, to the extent that the Board does not take such specific formal action, it will be necessary for the Courts to resolve the matter by applying or fashioning *Federal common law.*" Bank Board Resolution No. 75-647 15.

Thus, the Bank Board has stated officially that Federal common law must resolve problems, such as the effect of jurisdiction provisions which are not covered by a regulation or an advisory opinion. The effect of common law on the subject "law of the jurisdiction" clause appears in *Yazell*, *MacKenzie*, *Stewart*, *Dalton Motors* and *DeSimone*, *supra*, which hold unequivocally that such provisions mean what they say: state law governs.

IV.
CONCLUSION.

The judgment of the Court of Appeal should be affirmed.

Respectfully submitted,

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Appendix

APPENDIX A.

24 C.F.R. §402.05-22 (1938).

"Property transfers. (a) All requests for the written consent of the Corporation to the transfer of property on which it holds a security instrument shall be referred to the District Service Supervisor, who shall review the account and, if it is found to be delinquent, shall determine how the delinquency is to be remedied. If a liquidating program is proposed, the ability of the prospective purchaser to make the required payments shall be ascertained. Based on such investigation, the District Service Supervisor shall prepare a memorandum including his recommendation and forward it to the State Manager. If the State Manager determines that the consent shall be given, he may, with the advice of the State Counsel execute the necessary written consent to the transfer of the property upon the following conditions: (1) That the purchaser assume the obligation to the Corporation; (2) That the original mortgagor and any other parties now liable not be released; (3) That the lien held by the Corporation be not adversely affected. (b) Where the written consent of the Corporation to the transfer of property on which it holds a security instrument is not requested, but information is received from any source relative to a proposed transfer, reasonable effort shall be made to have the grantee assume the obligation in the instrument of conveyance or by separate instrument concurrently executed as the State Counsel may approve."

APPENDIX B.

24 C.F.R. §402.05-17 (1938 Supp.).

"§402.05-17 Property transfers. The Service Representative shall be responsible for the execution of Transfer of Property by Borrower Form 530 and Report on Deceased Borrower Form 531 in accordance with instructions in the Forms Manual in all such cases coming to their attention or referred to them by the Regional Office. All requests for the written consent of the Corporation to the transfer of property on which it holds a security instrument or installment contract or to the assignment of an installment contract shall be referred to the Regional Control Supervisor. Where such written consent is not requested, but information is received from any source relative to a proposed transfer, reasonable effort shall be made to have the grantee assume the obligation in the instrument of conveyance or by separate instrument concurrently executed as the Regional or State Counsel may approve. All cases of transfers of property on which the Corporation holds a loan or sales instrument and which come to the attention of the field, either before or after the transfer has been consummated shall be reported to the Regional Office on Form 530." Art. 205-17, Consolidated Manual, as amended Aug. 17, 1938, effective Sept. 1, 1938; 3 F.R. 2077.

APPENDIX C.

24 C.F.R. §209.46 (1946).

§209.46 *Borrowing member; transferee of mortgaged property:*

(a) Opinion. The transferee of property mortgaged to a Federal association does not automatically become a borrowing member of the association, nor does the transferor of such mortgage property automatically cease to be a borrowing member of such association. The transferee is substituted for the transferor and becomes a borrowing member of the association only if the transferee assumes the mortgage loan and the association, at the request of the transferor and of the transferee, accepts the transferee as a member. (Ch. K, Sec. 4; 24 C.F.R. and Supps., 202.9(a).)

(b) Discussion. Federal Charter K, Section 4, provides that all borrowers from such an association shall be deemed and held to be members thereof. The transferee of property mortgaged to a Federal association may fall into any of the following classes:

(1) Transferee assumes the mortgage debt and the association releases the transferor. The transferee will be a member.

(2) Transferee assumes the mortgage debt, but the transferor remains liable to the association for such a debt. The transferee will become a member if it is agreeable to the association to transfer such member.

(3) Transferee does not assume the mortgage debt. The transferee is not a borrower from the association and the transferor remains the borrower from the association although the transferor no longer owns the property securing the debt. The transferor, not the transferee, is the member of the association. It is noted that the above discussion does

not prevent a transferee of property on which a Federal association has a mortgage from becoming a member of the association by the purchase of shares.

APPENDIX D.

Each of the cases listed below involves a federal savings and loan association. Each case was decided by state law. The decisions are from both federal and state courts. These decisions show conclusively that appellant is incorrect in stating that the enactment of HOLA and promulgation of the "comprehensive" Bank Board regulations cover the entire field of operation of federal associations. Rather, the decisions reaffirm appellees' point that mutuals must follow state law *inter alia*, covering contracts, secured transactions and property transfers in the states in which they conduct business.

1. *First Federal S & L Ass'n. of Rochester, N.Y. v. Fisher*, 422 F. Supp. 1 (D.C. Ga. 1976), *aff'd*, 544 F. 2d 902 (5th Cir. 1977). (Georgia law employed to allow association to collect a second debt.)

2. *Calumet Federal S & L Ass'n. of Chicago v. Lake County Trust Co.*, 509 F. 2d 913 (7th Cir. 1975). (State law on wrongful foreclosure used to determine damages for federal association's failure to inform a second mortgagee of its intent to foreclose.)

3. *S & G Inv., Inc. v. Home Federal S & L Ass'n.*, 505 F. 2d 370, 164 U.S. App. D.C. 263 (D.C. Cir. 1974). (District of Columbia statutory code governs in a dispute regarding the propriety of a foreclosure sale.)

4. *Fidelity Federal S & L Ass'n. v. U.S.*, 445 F. Supp. 683, 686 (D.C. Tenn. 1978). (A redemption case involving the federal government. The Court notes that the federal lender followed Tennessee law to foreclose on secured property.)

5. *Fidelity Federal S & L Ass'n v. Pioneer National Title Ins. Co.*, 428 F. Supp. 1382 (D.C. Ill. 1977). (Contract

dispute between federal lender and title insurance company resolved by state law.)

6. *Montero v. First Federal S & L Ass'n. of Puerto Rico*, 385 F. Supp. 1072 (D.C. Puerto Rico 1974). (Law of Puerto Rico applied to validate loan foreclosure by federal lender.)

7. *Federal National Mortgage Ass'n. v. Kostrunck*, 228 F. Supp. 777 (D.C. Iowa 1964). (Law of state where land is located controlled as to method of mortgage foreclosure and rights of redemption.)

8. *Schmidt v. Interstate Federal S & L Ass'n.*, 74 F.R.D. 423, 428 (D.D.C. 1977). (The law of the jurisdiction where the mortgaged property lies governs common law claims for breach of contract against federal lender for violation of prepayment penalty regulation.)

9. *Dollar Federal S & L Ass'n. v. Herbert Kallen, Inc.*, 66 A.D. 2d 793 (N.Y. App. Div. 1978). (New York law used to interpret subrogation clause in federal association's mortgage in resolving dispute regarding insurance proceeds.)

10. *First Federal S & L Ass'n. v. Nieder*, 163 N.J. Super. 308 (1978). (New Jersey law employed to resolve a dispute for fire insurance proceeds between mutual, mortgagor and mortgagor's attorney.)

11. *New York and Suburban Federal S & L Ass'n. v. Sanderman*, 162 N.J. Super. 216 (Super. Ct. Ch. Div. 1978). (State law used to determine that federal lender could not be reimbursed for posting a guard.)

12. *Flynn v. Nashua Federal S & L Ass'n.*, 118 N.H. 84 (N.H. Supr. Ct. 1978). (New Hampshire law holds that the possible liability of third parties to mortgagors does not prevent mutual from foreclosing.)

13. *Al Springer Roofing Co. v. Flanger Federal S & L Ass'n.*, 357 So. 2d 478 (Fla. Dist. Ct. App. 1978). (Dispute concerning the finality of a federal association's foreclosure as to a contractor determined by state law.)

14. *City National Bank of Miami v. Home Federal S & L Ass'n. of Hollywood*, 356 So. 2d 814 (Fla. Dist. Ct. App. 1978). (Florida law holds that foreclosure by federal lender did not extinguish an attendant recreation lease.)

15. *Curl v. Federal S & L Ass'n. of Gainesville*, 241 Ga. 29 (Ga. Supr. Ct. 1978). (An effort to set aside federal association's foreclosure sale of secured property governed by Georgia law.)

16. *Grider v. Mutual Federal S & L Ass'n.*, 565 S.W. 2d 647 (Ky. App. 1978). (The law of Kentucky applied to give federal association's mortgage priority over material-man's lien.)

17. *Bell Federal S & L Ass'n. v. Horton*, 59 Ill. App. 3d 923 (1978). (Suit to overturn foreclosure sale by mutual based on improper service by publication of the foreclosure governed by Illinois law.)

18. *Marcon v. First Federal S & L Ass'n.*, 58 Ill. App. 3d 811 (1978). (Mortgagee's liability for damage caused by fire starting on the secured property governed by state law.)

19. *Reliance Federal S & L Ass'n. of New York v. Venet Homes, Inc.*, 57 A.D. 2d 830 (N.Y. App. Div. 1977). (The distribution of surplus monies after a foreclosure determined by the law of New York.)

20. *Franklin Society Federal S & L Ass'n. v. Far-Pap Corp.*, 57 A.D. 2d 607 (N.Y. App. Div. 1977). (A mort-gagor's attempt to cure a default of a mortgage held by mutual governed by state law.)

21. *Snead Construction Corp. v. First Federal S & L Ass'n.*, 342 So. 2d 517 (Fla. App. 1977). (Construction contractor's effort to have federal lender's previously recorded mortgages subordinated because they mentioned nothing about future advances governed by state law.)

22. *United of Florida, Inc. v. Illini Federal S & L Ass'n.*, 431 So. 2d 793 (Fla. App. 1977). (Florida law applied to give mechanic's lien priority over assignees of mutual's mortgage interest.)

23. *Dreckshage v. Community Federal S & L Ass'n.*, 555 S.W. 2d 314 (Mo. Supr. Ct. 1977). (Missouri law employed to resolve a claim of fraud in the subordination of trust deed instruments.)

24. *Pleasants v. Home Federal S & L Ass'n.*, 116 Ariz. 319 (Ariz. App. Ct. 1977). (Assumption fees and increase in interest rate exacted by defendant upon transfer of property not duress under Arizona contract law.)

25. *Fikes v. First Federal S & L Ass'n. of Anchorage*, 533 P. 2d 251 (Alaska Supr. Ct. 1975). (Alaska law employed to resolve a dispute between a vendee and beneficiary under a deed of trust.)

26. *Mishawaka Federal S & L Ass'n. v. Brademas*, 162 Ind. 401 (Ind. App. Ct. 1974). (The validity of the execution and acknowledgment of a mutual's loan instruments determined by reference to Indiana law.)

27. *Roberd v. First Federal S & L Ass'n.*, 490 S.W. 2d 243 (Tex. Civ. App. 1973). (Action to cancel lien held by mutual governed by Texas contract law.)

28. *Zelickman v. Bell Federal S & L Ass'n.*, 13 Ill. App. 3d 578 (Ill. Ct. App. 1973). (Illinois law relied upon to determine whether advance payments for taxes and insurance constituted a trust inuring to the benefit of borrowers.)

29. *Wiggins v. Searcy Federal S & L Ass'n.*, 253 Ark. 407 (Ark. Supr. Ct. 1972). (Arkansas law governs priority battle between an association's encumbrance and materialman's lien.)

30. *Lambert v. Home Federal S & L Ass'n.*, 481 S.W. 2d 770 (Tenn. Supr. Ct. 1972). (Breach of contract action involving the mortgage instruments of a federal lender subject to Tennessee's statute of frauds.)

31. *Martyn v. First Federal S & L Ass'n. of West Palm Beach*, 257 So. 2d 576 (Fla. App. Ct. 1971). (Florida law holds that contract to mortgage property is not a sale of an interest in land and therefore not subject to the statute of frauds.)

32. *Creasman v. First Federal S & L Ass'n. of Hendersonville*, 279 N.C. 361 (N.C. Supr. Ct. 1971). (Attempt to cancel note and deed of trust because the instruments were blank when signed governed by North Carolina law.)

33. *Sears v. First Federal S & L Ass'n. of Chicago*, 1 Ill. App. 3d 621 (1971) (Construction of mortgage instrument according to state law.)

34. *Guardian Federal S & L Ass'n. v. Suskind*, 265 A. 2d 295 (D.C. 1970). (The law of the District of Columbia governs priority dispute between purchase money mortgage and construction lender.)

35. *Drobnick v. Western Federal S & L Ass'n. of Denver*, 479 P. 2d 393 (Colo. App. Ct. 1970). (Colorado law applies regarding subordination of security interests to obtain lien priority.)

36. *Aronoff v. Western Federal S & L Ass'n.*, 28 Colo. App. 151 (Colo. App. Ct. 1970). (Colorado common law applied to construction of note and trust deed held by federal lender.)

37. *Roberts v. First Federal S & L Ass'n. of Manatee County*, 222 So. 2d 32 (Fla. App. Ct. 1969). (Florida law holds that mutual's lien has priority over surveyor's lien.)

38. *Washington Federal S & L Ass'n of Miami Beach v. Dade County*, 221 So. 2d 790 (Fla. App. Ct. 1968). (Florida has followed in determining rights of mortgagee under mortgage lien theory.)

39. *Pinellas County v. Clearwater Federal S & L Ass'n.*, 214 So. 2d 525 (Fla. Ct. 1968). (State law holds mortgage held by federal lender to be a lien upon specific property, either real or personal.)

40. *Citizens Federal S & L Ass'n. v. Andrews*, 114 Ga. App. 94 (1966). (Interpretation of an "open-end clause" in a federal lender's security instrument according to Georgia law.)

41. *Apex Siding and Roofing Co. v. First Federal S & L Ass'n.*, 301 P. 2d 352 (Okl. Supr. Ct. 1956). (The doctrine of equitable estoppel applied against federal lender to give materialman's lien priority.)

42. *Antrim Lumber Co. v. Claremore Federal S & L Ass'n.*, 204 Okl. 387 (Okl. Supr. Ct. 1951). (Law of Oklahoma applied to give mortgage held by federal lender priority over materialman's lien.)

43. *First Federal S & L Ass'n. of Couer D'Alene v. Marsh*, 19 Wash. 2d 438. (Wash. Supr. Ct. 1943). (Washington law applied to issue of redemption rights after foreclosure by mutual.)

44. *Grayson v. Security Federal Savings and Loan Association of Tulsa*, 192 Okl. 149 (Okl. Sup. Court 1943). (The propriety of a foreclosure sale of real estate governed by state law.)

45. *Wichita Federal Savings and Loan Association v. Jones*, 155 Kan. 821 (Kan. Sup. Court 1942). (Law of

Kansas applied to estop federal lender from claiming priority over materialman's claims.)

46. *Hazlett v. First Federal Savings and Loan Association*, 14 Wash. 2d 124 (Wash. Sup. Court 1942). (Federal lender's alleged promise to obtain fire insurance held gratuitous and unenforceable under state contract law.)

47. *Hesse v. Railway Federal Savings and Loan Association*, 46 Cal. App. 2d 111 (1941). (Dispute regarding inclusion of advances in trust deed held by mutual resolved by California law.)

48. *Platts v. Pacific First Federal Savings and Loan Association*, 62 Ida. 340 (Idaho Sup. Court 1941). (Issues concerning reconveyance of a mortgage held by mutual and judgment lien decided by state law.)

APPENDIX E.

Fair Housing Amendments Act of 1980.

Calendar No. 1001.

96th Congress, 2d Session, Senate Report No. 96-919.

Report Together With Minority and Additional Views of the Committee on the Judiciary, United States Senate on S. 506, as amended.

[Seal]

August 26 (legislative day, June 12), 1980. — Ordered to be printed.

* * *

[26] . . . S. 506 reenacts Section 815 of Title VIII which gives State and local jurisdictions the authority to pass stronger and broader laws that go beyond the Federal Fair Housing Act. The Committee notes the recent decision of the Ninth Circuit Court of Appeals in *Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1979), aff'd without opinion, 100 S.Ct. 1304 (1980). In the *Stein* case, the Court of Appeals held that California officials could not, under the pre-emption doctrine, exercise their regulatory authority under a state anti-redlining statute with respect to federally regulated savings and loan institutions. The Court of Appeals did not decide the question whether California could validly enforce "substantive non-discrimination provisions" of the State anti-redlining law against Federal savings and loan institutions. The United States Supreme Court, without plenary consideration and without a written opinion, summarily affirmed the judgment of the Ninth Circuit in the *Stein* case. Although the *Stein* decision is very narrow and limited, it nonetheless appears inconsistent: (1) with Section 815 of Title VIII, which the Court of Appeals did not mention; and (2) with Supreme

Court decisions refusing to apply the pre-emption doctrine when States seek to enforce their nondiscrimination laws against federally regulated industries. See, *Colorado Anti-Discrimination Commission v. Continental Air Lines, Inc.*, 372 U.S. 714 (1963). Consequently, the pre-emption question under Section 815 and Title VIII, especially as it related to individual complaints of housing discrimination, is still open and subject to further litigation. Thus, there is no need at this time to amend Section 815. It is noted that even in the area of admiralty and maritime jurisdiction, which is fraught with notions of federal exclusivity, see *Southern Pacific Co. v. Jensen*, 244 U.S. 205 (1917), the Supreme Court has permitted States to exercise legislative authority in the face of a federal remedial statute administered by a federal agency. *Sun Ship Inc. v. Pennsylvania*, 100 S.Ct. 2432 (1980).

Appellant's Reply Brief

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No. 81-750

IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

REGINALD D. de la CUESTA, *et al.*,
Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

ALPHONSO MOORE, *et al.*,
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FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
Appellants,

vs.

JOHN D. WHITCOMBE,
Appellee.

**On Appeal from the California Court of Appeal,
Fourth Appellate District.**

APPELLANTS' REPLY BRIEF

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Appellee.

APPELLANTS' REPLY BRIEF

Congress Has Given the Bank Board the Authority to Adopt Regulations Which Preempt State Law.

Appellees ("Purchasers") and their various amici argue that Congress did not intend that the Bank Board have the power to preempt state real property and mortgage law, particularly as it pertains to due-on-sale clauses in mortgage

loan contracts of federal savings and loan associations. They refer repeatedly to the traditional role of state law in these areas.

This argument overlooks the fact that the Bank Board has, at the very least, a paramount interest in mortgage loan contracts made by federal savings and loan associations because the primary business of these associations is the generation of mortgage loan contracts, *i.e.* mortgage loans. Indeed, there can be no dispute that a significant purpose of the Congress in enacting the Home Owners' Loan Act of 1933 ("HOLA") was to establish a financial intermediary which would engage in the business of generating mortgage loan contracts. This is evidenced by Section 5(a) of the HOLA which expressly states that the Bank Board is to charter and regulate federal savings and loan associations "in order to provide for the financing of homes." (12 U.S.C. § 1464(a)). In pursuit of this purpose, at December 31, 1981, for example, savings and loan associations in the United States held $518.4 billion in mortgage contracts representing 78% of all of the assets of these associations, and of these associations, about 50% are federally chartered.[1]

The concern by the Bank Board for the terms of the mortgage loan contracts entered into by Federal associations has long been expressed in regulations adopted by the Bank Board. These regulations also evidence the intention of the Bank Board to protect the borrower as well as the Federal association. As early as November 1936 the Bank Board had regulations both general and specific in content as to the terms of mortgage loan contracts which Federal associations could offer their borrowers. As a general matter, all terms of mortgage loan contracts, pursuant to the reg-

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[1]Federal Home Loan Bank Board Journal, March 1982, p. 44 and p. 46.

ulations, were subject to Bank Board review and approval. In respect to specific matters, the regulations dealt with the types of loans permitted, loan-to-value ratios, loan origination charges, variable interest rate provisions, and late charges. (The full text of Sections 39 and 40 of the Bank Board's November 10, 1936 regulations are reproduced as an appendix hereto). The present regulations, in similar fashion, deal with the requirement that mortgage loan contracts provide for the maintenance of hazard insurance on the real property security (12 C.F.R. § 571.4); delineate types of mortgage loan contracts for homes which a federal association can enter into (12 C.F.R. § 545.6-2); provide the maximum rates of interest increase, the loan-to-value limitations and the contents of the notice which is to be given to a borrower with respect to a graduated payment mortgage loan contract (12 C.F.R. § 545.6-4(b)); and provide the type of index which must be employed and the contents of the form of notice which the Federal association must give to the borrower in connection with an adjustable rate mortgage loan contract (12 C.F.R. § 545.6-4(a)).[2] The Bank Board regulations respecting due-on-sale provisions in mortgage loan contracts, as well as the regulations referred to above, are fully consistent with the fundamental fact that the primary business of savings and loan associations is to make and hold mortgage loan contracts. It is consistent also with the long tradition of the Bank Board since HOLA was enacted to issue regulations which impinge directly upon the terms of and defined the nature of the mortgage loan contract which a Federal association is authorized to make. The Purchasers are wrong in asserting

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[2]Other Bank Board regulations pertaining to the lending activities of federal associations are at 12 C.F.R. §§ 545.6 through 545.8-10, and §556.9.

that mortgage loan contracts of Federal associations are an exclusive concern of state authorities and state law.

In a similar vein the Purchasers argue that Congress has not authorized the Bank Board to issue regulations respecting mortgage loan contracts. We see no merit to this argument. In adopting Section 5(a) of HOLA, Congress not only granted to the Bank Board the authority to make "rules and regulations" with respect to Federal associations but set forth the specific areas to which the rules and regulations may apply, viz: "the organization, incorporation, examination, operation and regulation of associations . . ." (12 U.S.C. § 1464(a)). The key area of this statute with respect to the due-on-sale issue is the Bank Board's authority to make rules and regulations with respect to the "operation" of Federal associations. As we have shown above, a principal element of the operation of a Federal association involves the making of mortgage loan contracts (the other principal business of Federal associations is the making of savings contracts). That Congress has specifically authorized the Bank Board to deal with the operations of Federal associations is incontrovertible. Thus, clear authority exists in Section 5(a) of HOLA to permit the Bank Board to extend regulations to mortgage loan contracts, a primary operation of Federal associations.[3]

This Court has repeatedly instructed that the search for congressional intent must begin with the language of the statute. "We look *first*, of course, to the statutory language.

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[3]While by no means dispositive, it is noteworthy that the regulations cited, *supra*, at footnote 2 and the text thereto, including the due-on-sale regulations, are within Part 545 which Part is titled "OPERATIONS". 12 C.F.R. § 545 *et seq*. Sections 545.1 through 545.5 deal with "Savings Accounts," while Sections 545.6 through 545.8-10 deal with "Real Estate Loans," "Other Loans," and "General Provisions Respecting Loans."

. . . [*t*]*hen* we review the legislative history and other traditional aids of statutory interpretation to determine congressional intent." *Middlesex County Sewerage Authority v. National Sea Clammers Association*, 453 U.S. 1, 101 S. Ct. 2615, 2622-2623 (1981) (emphasis added). "The search for congressional intent *begins* with the language of the statute." *Steadman v. Securities and Exchange Commission*, 450 U.S. 91, 97 (1981) (emphasis added). *See also, Rubin v. United States*, 449 U.S. 424, 430 (1981) where this Court held that when the statutory language is unambiguous, resort to legislative history is rarely necessary.

We submit that in using the word "operation" in Section 5(a) that Congress meant the traditional business activities of savings and loan associations, *i.e.* the taking in of deposits and the creating of mortgage loan contracts, as specified in the opening sentence of Section 5(a). The intent of Congress to provide the Bank Board with authority to control the due-on-sale content of a mortgage loan contract, we believe, is manifest from the literal language of Section 5(a).

Further evidence of the congressional intent to provide authority over the operations of Federal associations is found in the qualifying phrase in Section 5(a) instructing the Bank Board in adopting rules and regulations to give "primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States" (12 U.S.C. § 1464(a)). This qualifying clause is patently inconsistent with the Purchasers' position that, with respect to the enforcement of the terms of mortgage loan contracts, the only course appropriate is to apply state law. If state law was inexorably applicable to mortgage loan contracts of Federal associations the qualifying clause would be meaningless. The statute has given the Bank Board the right to select and to reject among the practices of other savings and

loan associations those which Federal associations shall follow. The enforcement of due-on-sale clauses of mortgage loan contracts according to their terms are among the practices banned for some state chartered and regulated associations while permitted for others.[4] Despite this ban, Section 5(a) gives the Bank Board the right, in the exercise of its discretion, to select the due-on-sale practice for use by Federal associations. In making that selection, the Bank Board, as reflected in Resolution No. 75-647, dated July 30, 1975 (*see* R. 916) conducted a thorough review of due-on-sale practices by financial intermediaries located in the various states at the request of the court in *Schott v. Mission Federal Savings and Loan Association*, United States District Court, Central District of California, No. CV-75-366-WMB (the "Schott Opinion"). The Bank Board, in its resolution, specifically concluded that inclusion of due-on-sale clauses into mortgage loan contracts, and the exercise of such clauses according to their terms (unimpaired by state law) was necessary to the financial stability of Federal associations, as well as being of long term benefit to consumers. (R. 953).[5] Thereafter, in 1976, the Bank Board adopted regulations consistent with its earlier review which regulations permit due-on-sale clauses to be exercised consistent with the terms of the mortgage loan contracts.[6]

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[4]Compare *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978) with *Occidental Savings and Loan Association v. Venco Partnership*, 206 Neb. 469, 293 N.W. 2d 843 (1981); and *Lipps v. First American Service Corp.*, Supreme Court of Virginia (Jan. 22, 1982). *See also* the cases collected in Fidelity Federal's Jurisdictional Statement at page 9, footnote 9.

[5]The full text of Resolution No. 75-647, the *Schott* Opinion, is also reproduced in the appendix, pp. 38-88, to the Jurisdictional Statement in *California Federal Savings and Loan Association v. Tan*, docketed as No. 81-993.

[6]The Bank Board's due-on-sale regulations were originally adopted by its Resolution No. 76-296, April 28, 1976, as 12 C.F.R. §§ 545.6-11(f) and (g). See the Jurisdictional Statement herein at pp. 43a-49a. The regulations were later recodified at §§ 545.8-3(f) and (g), without substantive change.

Thus, the selection by the Bank Board of the due-on-sale practice for Federal associations was careful and exhaustive, and clearly consistent with the provisions of the qualifying clause of Section 5(a) of HOLA. Moreover, the regulations were adopted in full compliance with the Administrative Procedures Act, particularly 5 U.S.C. § 553. See 41 Fed. Reg. 6283-87 (February 12, 1976), and 41 Fed. Reg. 18286 (May 3, 1976).[7]

The foregoing demonstrates that Congress intended the Bank Board to have the power to adopt regulations governing the mortgage loan contract activities of Federal associations. Further, the instant due-on-sale regulations were

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[7]Significantly, Amicus, The Secretary of the Business, Transportation, and Housing Agency of the State of California ("Secretary") who complains in her Amicus Brief at 7-9 that the Bank Board has not complied with the APA nor given notice that it intended its regulations to be preemptive replied to the regulations when published for comment. The Secretary complained by letter dated March 19, 1976 that the proposed regulations were intended to preempt California law on due-on-sale, stating:

> It is clear from a review of the proposed regulation that there are a number of situations where the exercise of due on sale clauses would be in violation of California law while at the same time not explicitly violating the provisions of proposed Section 545.6-11(f) and (g). It also seems apparent that the intent of the proposed regulations is specifically to exempt Federal associations from complying with State law relating to the exercise of due on sale clauses. This is indicated both by the discussions in the preamble to the proposed regulation, which points to controversy and litigation in "certain states" as the reason the Board deems it desirable to propose the regulation, and from language in the proposed regulation itself (e.g. the phrase in proposed Section 545.6(f) [that the due-on-sale clause] "shall be governed exclusively by the terms of the loan contract between the association and the borrower and all rights and remedies of the association and borrower respecting such acceleration shall be fixed and governed by said loan contract").

The Secretary is thus now in no position to argue that the regulations as ultimately adopted evidence no intent nor give any notice that they are in preemption of state law. The Court below also had no problem concluding that the Bank Board clearly intended its regulations to be preemptive. (J.S. App. at 15a).

validly enacted, are consistent with the Bank Board's authority under Section 5(a), and are intended by the Bank Board to control irrespective of state due-on-sale law. Accordingly, under the authority of this Court's decisions in such cases as *Free v. Bland*, 369 U.S. 663 (1962), and *United States v. Shimer*, 367 U.S. 374 (1961), state due-on-sale law is preempted by the Bank Board due-on-sale regulations.

Finally, while the Purchasers argue at some length that there is no unavoidable "conflict" between state and federal law, they ignore the fact that the federal government has authorized Federal associations to engage in a practice which state law forbids — *i.e.*, the exercise of due-on-sale clauses to upgrade the rate of return on real estate loans. There is a preemptive conflict whenever state law interferes with the exercise of powers granted by federal law. *See Franklin National Bank v. New York*, 347 U.S. 373, 376-379 (1954).

An Obligation Is Not Real Property.

The argument by the Purchasers that the enforcement of the due-on-sale provisions of a mortgage loan contract constitutes a restraint upon the alienation of the real property security for the loans is greatly exaggerated. The owner of the real property which secures a loan may sell the property at any time, to anyone, at any price, without the consent of the lender. A consent is required only when the borrower also seeks to transfer the loan (*i.e.* the borrower's obligation) made by the lender as to which the property is security and is limited only to the ability to transfer the loan. Thus, no consent is required if no attempt is made by the borrower to transfer the lender's loan, by discharging the obligation, when the borrower transfers the property.

A corollary to the foregoing, is that the real property is incidental to the mortgage loan contract. It is the security

for the loan. In fact, the real property which is the security for the loan may not necessarily be the real property for which the loan was obtained. The principal element of the mortgage loan contract is the borrowing of money, not the transfer of real property. Few of an association's mortgage loan contracts ultimately require satisfaction by foreclosure of the real property security.[8] Federal savings and loan associations primarily are in the mortgage loan contract business and only incidentally in the real property business. Thus, the Purchasers' efforts to establish that great issues of real property law are at stake here is a gross exaggeration. The due-on-sale regulations of the Bank Board, at most, represent a minor impingement on the real property law of a state.

Section 5(a) of the HOLA Contains No Internal/External Affairs Test.

The internal/external affairs test for Bank Board authority to regulate announced by the Court below, which has been fastened upon by the Purchasers and their amici, is illusory when read in connection with the plain language of Section 5(a). It is at once clear that Section 5(a) on its face contains no such distinction. Furthermore, in none of the cases cited by the Purchasers in support of the internal/external distinction is there any reasoned analysis linking the distinction with the language of Section 5(a). This is particularly true with respect to *Gulf Federal Savings and Loan Association v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir. 1981), petition for certiorari pending, No. 81-1744, upon which the Purchasers heavily rely. Moreover, the statute in issue in *Gulf* was not Section 5(a) of HOLA and is different

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[8]For the period of January 1981 through June 1981 the foreclosure rate of all insured associations was .083%. Federal Home Loan Bank Board Journal, March 1982 at p. 55.

in its text. The statutory issue in *Gulf* concerned the authority of the Bank Board to issue cease and desist orders to Federal associations. In contrast to Section 5(a) of HOLA which denominated the areas in which the Bank Board could issue regulations, the particular statute involved in *Gulf* is not so explicit. Moreover, the *Gulf* Court did not cite, quote, discuss, or analyze Section 5(a). The Court did nothing more than assume the conclusion by rejecting cases cited to it by the Bank Board on the basis that those cases dealt with internal management. *See Gulf, supra*, 651 F.2d at 266.

Other Courts, including this Court, have found preemption by reason of the language of Section 5(a) even though the issues under consideration involved arguably "external" issues, including the mortgage loan contract relationship between the federal association and its borrower. *See, Conference of Federal Savings and Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1978), *aff'd mem.*, 445 U.S. 921 (1980); *First Federal Savings and Loan Association of Boston v. Greenwald*, 591 F.2d 417, 425 (1st Cir. 1979); *Meyers v. Beverly Hills Federal Savings and Loan Association*, 499 F.2d 1145, 1147 (9th Cir. 1974)[9]; *Kaski v. First Federal Savings and Loan Association*, 72 Wis. 2d 132, 140-142, 240 N.W. 367 (1976); and *Derenco Inc. v. Benjamin Franklin Federal Savings and Loan Association*, 281 Or. 533, 564-566, 577 P.2d 477 (1978).

Nothing in the text of Section 5(a) supports the Purchasers' argument that an internal/external distinction exists as to the operations of Federal associations. The few courts

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[9]The Purchasers argue that *Meyer* is no longer good law because its reasoning was not followed in a later case (which did not involve either a Federal association, or § 5(a), or cite *Meyer*). Appellees' Brief at 41 fn. 59. They fail to note that *Meyer* was heavily relied on and quoted as controlling in the still later Ninth Circuit decision in *Conference v. Stein, supra*.

which have adopted this dichotomy have drawn a line which the plain language of Section 5(a) does not permit.

If the internal/external distinction were upheld, including the decision of the Court below that the mortgage loan contracts of a Federal association are external operations, the result would be that Federal associations would be compelled to make only those mortgage loans expressly sanctioned by the laws of the states in which they operate even if those forms of mortgage loan contracts are considered inappropriate by the Bank Board. Hence, to read the internal/external distinction into Section 5(a) would mean that Congress in enacting HOLA intended nothing more than that the Bank Board create federally chartered but state operated and controlled associations. Nothing in the language of Section 5(a) nor in the legislative history of HOLA permits this conclusion.[10]

The Entire Legislative History Supports a Conclusion of Preemption.

The legislative history of HOLA is sparse. However, such legislative history as there is is fully consistent with the plain language of Section 5(a). The Purchasers and their amici cite to several isolated bits of testimony given when the HOLA was adopted. Analysis of these comments reflects that the Bank Board's power to preempt state law was intended by Congress. Thus, that Federal associations were to be locally managed and operated mutual associations (Appellees' Brief at 20-21) does not in the least preclude

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[10]Of more immediate concern is the devastating impact that validation of the internal/external distinction would have on the existing regulations (noted above in footnote 2, and preceding text), and on the billions of dollars of loans made in reliance on those regulations, which loans may be contrary to one or more state laws. If the due-on-sale clause regulations improperly regulate "external" activities of Federal associations then the above noted regulations all also suffer from the same malady.

the notion that Bank Board rules and regulations would nonetheless apply uniformly across the nation to all Federal associations. Further, the quotation from the first Chairman of the Bank Board, Mr. Stevenson, quoted in Appellees' Brief at 23, fn. 30, wherein he states that he as a member of the Bank Board would be "careful" in authorizing Federal associations to do that which might be prohibited by state law argues more for a recognition of preemptive power than against it. If no power to preempt state law was contemplated Mr. Stevenson would need no "policy" and would have no need to be "careful" before adopting preemptive regulations. The recognition by Mr. Stevenson of a need to be conscious when permitting Federal associations to act contrary to state law clearly reflects an awareness by him that preemptive power under § 5(a) existed.

While this Court has noted that the view of subsequent Congresses is generally of limited utility in defining an earlier Congress' intent, the Court has stated that the view of subsequent Congresses is entitled to significant weight when subsequent legislation not only fails to overturn the administrative construction of the statute but is fully consistent with that administrative construction. *Red Lion Broadcasting Co. v. Federal Communications Commission*, 395 U.S. 367, 380-81 (1969). As noted in Appellants' Brief at page 22, Congress has amended the HOLA (including Section 5(a)) on at least six occasions since the Bank Board declared that its due-on-sale regulations and not state law were to be followed by federal associations. Yet, not once did Congress enact any amendment to Section 5(a) which could be read to undercut the Bank Board's administrative construction of its power. The amendments recently added to Section 5(a) with respect to state savings banks converting to a federal charter (and to Bank Board control from state control) requiring them (but not federal savings and loan

associations) to continue to comply with certain specifically enumerated state laws should compel the conclusion that when Congress intends to place state law limitations upon Section 5(a) that Congress knows how to do so.[11] As to Federal associations, no such limitation on Bank Board authority has been added to Section 5(a). Thus, it is clear that Section 5(a) grants to the Bank Board preemptive power as to the savings and mortgage loan activities (the "operation") of Federal associations. *See* 124 Cong. Rec. H. 11743-11745 (Oct. 5, 1978).[12]

The Purchasers' constant reference to the sanctity of state real property and mortgage law is also unavailing. This Court has held that where the federal presence has properly been invoked the federal law is supreme over state law as to real property and mortgages issues and also over other areas of traditional state concern. In *Hauenstein v. Lynham*, 100 U.S. 483 (1880) this Court held that a treaty giving Swiss nationals certain rights as to real property owned by resident Swiss nationals who died intestate controlled, notwithstanding the contrary law of Virginia, where the real

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[11] The current text of Section 5(a), including the noted amendments, is reproduced at pages 37a-39a of the Jurisdictional Statement herein.

[12] The Purchasers in their Appellees' Brief at 24, footnote 32, and Amicus Secretary in her Brief at 10-11 quote a portion of a Senate Committee Report and infer that this represents congressional opposition to preemptive federal regulations. The reference is most disingenuous. The Purchasers and the Secretary fail to note that the legislation to which the Report relates would strip away from federal financial regulatory agencies (such as the Bank Board) its power to issue preemptive regulations. They also fail to note that at least three Senators filed dissenting views (1974 U.S. Code Cong. & Ad. News 6119, at 6146). Finally, they fail to note that the entire Congress rejected the Senate effort to enact legislation clipping the wings of the affected agencies: "The Senate receded to the House." Conference Report No. 93-1429, 1974 U.S. Code Cong. & Ad. News 6148, at 6151.

property was located.[13] In *Free v. Bland, supra*, federal regulations prescribing rights of survivorship (traditionally a matter of local concern) which differed from otherwise applicable state law prevailed. The Pennsylvania anti-deficiency legislation (which relates to land foreclosure matters) was held inapplicable by reason of federal regulations in *United States v. Shimer, supra*. Most recently, in *Ridgeway v. Ridgeway*, __ U.S. __, 102 S. Ct. 49 (1981) this Court held that state family law must yield to federal regulations pertaining to benefits paid under a life insurance policy issued to a serviceman. Although not denying that matters relating to its citizens and traditionally a function of state law are important to the state, this Court has held that when Congress has the power to act, and has acted directly or through a federal agency to preempt, state law must yield. *Free v. Bland, supra*, 369 U.S. at 666.

Application of State Law to Loans Executed Prior to 1976 Is Preempted.

Contrary to the Purchasers' contentions, the Bank Board due-on-sale regulations do not unlawfully act retroactively. The regulations merely insure that state laws which inhibit the free exercise of the long-standing due-on-sale clause in a Federal association mortgage loan contract will not be effective. The Bank Board in adopting these regulations (as well as in the regulations themselves) clearly expressed its intention that Federal associations should "continue" to have the right to include automatically enforceable due-on-sale clauses in their mortgage loan contracts. 12 C.F.R. § 545.8-3(f). *See also* 41 Fed. Reg. 18286, May 3, 1976.

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[13]Interestingly, the Supreme Court of California recognized this power of the Supremacy Clause to invalidate state real property laws as to aliens who died intestate twenty-five years earlier in *People v. Gerke*, 5 Cal. 381 (1855).

The regulation unmistakably speaks in terms of a clause whereby the association "may, at its option, declare immediately due and payable" the principal balance of the mortgage note in the event of a transfer of the real property security without consent. 12 C.F.R. § 545.8-3(f). Moreover, the regulation states explicitly that due-on-sale clauses, whenever negotiated, may be "exercise[d]," with certain specific restrictions applicable to "any loan made after July 31, 1976." Clauses adopted at an earlier time may be exercised under the regulation without those restrictions.

Hence, the regulations do not create new rights nor change any terms for which the parties had previously contracted. The regulations do not insert due-on-sale clauses in contracts where none previously existed. Instead, the regulations merely permit mortgage loan contracts to be performed according to their literal terms, subject only to certain federal regulatory restraints, (12 C.F.R. § 545.8-3(g)) notwithstanding any other requirements of state law.[14]

The conclusion that the regulations permit federal associations to exercise due-on-sale clauses in their mortgage loan contracts notwithstanding the requirements of state law is particularly compelling here where at the time each of the three deeds of trust were executed the law of California was fully consistent with the Bank Board's position. The deeds of trust in *de la Cuesta* and in *Whitcombe* were executed in 1971 and 1972, respectively (J.A. at 36, 115). The due-on-sale clause was then freely exercisable under the authority of the California Supreme Court's decision in *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 38 Cal. Rptr.

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[14]As noted earlier, the present due-on-sale regulations followed the Bank Board's *Schott* Opinion wherein the Bank Board had concluded that Federal associations had been using and freely enforcing such due-on-sale clauses for some time, all with the Bank Board's knowledge and approval. (R. 928-930).

505 (1964). *See also Cherry v. Home Savings and Loan Association*, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (2d Dist. 1969). The deed of trust involved in *Moore* was executed on March 1, 1978 (J.A. at 73). The Bank Board regulations were effective in June, 1976. The California state due-on-sale law of *Coast Bank* was not changed until the date of finality of *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978), September 24, 1978. Thus, the state *Wellenkamp* decision seeks to deprive Appellant Fidelity Federal of the benefits of due-on-sale clauses which were valid when negotiated and given full protection by preemptive federal regulations adopted effective over two full years prior to *Wellenkamp*. For the Purchasers and their amici to cry foul under these circumstances, we submit, is specious.

In *Derenco, supra*, the Oregon Supreme Court concluded that Federal associations were not exempted from complying with Oregon law as to payments of interest on mortgage loan impound accounts for taxes and insurance *prior* to the adoption of preemptive federal regulations on the subject. Thereafter, the Court held, federal law alone was applicable *— even as to loans made prior to the adoption of the federal regulations*. 281 Or. at 564-566. *Accord, First Federal Savings and Loan Association of Boston v. Greenwald, supra*, 591 F.2d at 425-426.

The Court's decisions which, in general, require that the law be enforced as in effect on the date of decision provide further support for the conclusion that the Bank Board's due-on-sale regulations have full effect as to all mortgage loan contracts containing automatically enforceable due-on-sale clauses regardless of when executed.

In *Bradley v. School Board of the City of Richmond*, 416 U.S. 696 (1974) the Court stated the general rule that actions must be decided by appellate courts based upon the law in

effect on the date of the appellate decision, even when that law differs from the law in effect when the trial court ruled. 416 U.S. at 711. *See also, Thorpe v. Housing Authority of the City of Durham*, 393 U.S. 268 (1969). The case relied upon by the Purchasers and their amici, *Green v. United States*, 376 U.S. 149 (1964) has been held by this Court to be the *exception* to the general rule, an exception applied to prevent manifest injustice. *See Bradley, supra*, 416 U.S. at 717, fn. 24. Manifest injustice occurs when vested rights are infringed by retrospective application of changes of law. *Green, supra*, 376 U.S. at 160. The Purchasers here are in no position to argue that they had any vested rights to avoid the unimpaired exercise of the due-on-sale clause in the mortgage loan contracts here in issue since the law of California permitted the clause to be so exercised when their contracts were executed. Much later, the California Supreme Court in its decision in *Wellenkamp* changed the California law then in effect. *Wellenkamp*, 21 Cal. 3d at 953. That court concluded that lenders had gained no vested rights to enforce the due-on-sale clauses under the law as it existed prior to *Wellenkamp* so as to prevent application of its decision to existing contracts. 21 Cal. 3d at 954. It would thus be most anomalous to now hold that borrowers who entered into mortgage loan contracts when the law permitted *full* enforcement of due-on-sale clauses obtained vested rights to prevent enforcement of these clauses by reason of the *subsequent Wellenkamp* decision. There is thus no manifest injustice perpetrated by giving full effect to regulations which do nothing more than prevent state laws from interfering with enforcement of mortgage loan contracts according to their literal terms.

Conclusion.

Congress gave the Bank Board full authority to regulate the "operation" of federal savings and loan associations. The principal activity of savings and loan associations are

their mortgage loan contract activities. By a series of regulations the Bank Board has permitted Federal associations to use and exercise due-on-sale clauses in their mortgage loan contract activities thereby preempting any state prohibition. The trial court correctly concluded that the regulations preempt state law. The California Court of Appeal erroneously ruled to the contrary. For the reasons stated herein and in the Appellants' Brief on the Merits the decision of the California Court of Appeal should be reversed.

Dated: April 15, 1982

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Appendix

APPENDIX.

Federal Home Loan Bank Board Regulations, November 10, 1936.

REAL-ESTATE LOANS

Section 39.

(a) All loans on real-estate security made by each Federal association operating under a charter in the form of Exhibit E annexed hereto shall be on the direct reduction plan, unless the Board shall specifically approve another loan plan upon application therefor.

(b) When the members of a Federal association at a legal meeting have authorized loans to be made, from time to time, in an amount exceeding 75 percent of the value of the security of a home or combination home and business property, the association may make any such loan, provided the amount loaned is not in excess of 80 percent of the value of the security therefor.

(c) No director, officer, or employee of a Federal association shall receive any fee or other compensation of any kind in connection with the procuring of any loan made by such association. Borrowers may be required to pay the necessary initial charge in connection with the making of a loan, including the actual cost of title examination, appraisal, credit report, survey, drawing of papers, closing of the loan, and other necessary incidental services and costs in such reasonable amounts as may be fixed by the board of directors. Such necessary initial charges may be collected by the Federal association from the borrower and paid to any persons, including any director, officer, or employee, rendering such services. Whether such charges are so collected and paid or are paid directly by the borrower, a detailed record, including names of recipients of such

charges and amounts paid to each, shall be kept by the Federal association, and a copy of such record shall be given to the borrower.

LOAN CONTRACT

Section 40. Loans shall be evidenced by a note or bond for the amount of the loan, which shall clearly state the rate of interest charged and, if any additional charge is to be made on account of delinquent payments, of, if the rate is to vary upon any other contingency or option, the provision for such additional rate or additional charge shall be plainly stated in connection with the statement of the amount of the loan and the rate charged thereon. Each association shall be governed by the following provisions relevant to such charges:

(1) It may incorporate into its note and mortgage forms or other instruments securing the debt a provision whereby the stipulated rate of interest may be increased at the option of the association; provided, however, that the association may not exercise such right in less than 3 years from the date of the loan and then only upon at least 4 months' written notice to the borrower. The association shall incorporate in such instruments a provision that in the event of such an increase in the stipulated rate of interest the borrower may prepay the loan within such notice period without the payment of any additional interest or any other penalty.

(2) It may also incorporate a provision for an additional charge against borrowers who are delinquent in their loan payments. Such additional charge shall be in the form of an increased rate of interest on the unpaid balance of the loan for the period of delinquency.

Both form and substance of loan contracts are required to be fair and reasonable. All contract forms and all changes in contract forms for the making of loans shall be furnished promptly to the Board through the Federal Home Loan Bank of which the association is a member, and the same may be used unless and until disapproved by the Board.

Amicus Brief

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

v.

REGINALD D. DE LA CUESTA, *et al.*,

Appellees.

On Appeal from the California Court of Appeal for the Fourth Appellate District

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BRIEF OF THE AMERICAN SAVINGS AND LOAN LEAGUE AS *AMICUS CURIAE* IN SUPPORT OF APPELLANTS

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I.

INTEREST OF *AMICUS CURIAE*

The American Savings and Loan League ("the American League") is a trade association composed of savings and loan associations in the United States that are owned and operated predominantly by Blacks, Hispanics, Orientals, and members of other racial or ethnic minorities. Formed more than 32 years ago, its current membership includes 70 savings and loan associations operating in 25 states and the District of Columbia and having assets in excess of $2.5 billion. More than half of the members are federally chartered associations. Eighteen of the members are located in California.

As a trade association composed of minority owned and operated savings and loan associations, the American League is dedicated to promoting the availability of mortgage credit to members of racial and ethnic minorities for the purchase of homes and other real estate. Over the years, the American League has, through lobbying, education, litigation, and other means, vigorously — and effectively — endeavored to achieve this goal.

This appeal concerns the respective roles of the Federal Home Loan Bank Board ("the Bank Board") and the several states in regulating the mortgage lending practices of federal savings and loan associations. In particular, it presents the question of whether the Court of Appeal of the State of California for the Fourth Appellate District, Division Two, erred in holding that a federal law, the Home Owners' Loan Act of 1933, 12 U.S.C. (& Supp. III) §1461, *et seq.* ("HOLA"), and the comprehensive body of regulations that the Bank Board has issued thereunder, does not preempt the application of California Civil Code §711, as interpreted in *Wellenkamp v. Bank of America,* 21 Cal.3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978), and that

said California statute circumscribed or prohibited the exercise of the "due-on-sale" clause contained in the mortgage lending instruments of federal associations. Since resolution of this question will affect the ability of members of racial and ethnic groups to secure mortgage credit, it is a matter of material concern to the American League and its members.

II.

SUMMARY OF ARGUMENT

Regulations of the Bank Board, specifically, 12 C.F.R. 545.8-3(f) and (g), explicitly authorize federal associations, subject to specified limitations, to include and exercise "due-on-sale" clauses in mortgage loan contracts for the purpose of adjusting the yield on a loan to current market levels when the property is sold or transferred. California law, however, as interpreted by the California Supreme Court in *Wellenkamp v. Bank of America*, 21 Cal.3d 943, 582 P.2d 970, 148 Cal. Rptr 379 (1978), prohibits said exercise as "unreasonable"; and the Court of Appeal herein has determined that the state prohibition applies to federal associations.

The American League believes that the right of federal associations to exercise the "due-on-sale" clause for the purpose of adjusting interest rates contributes to the wider availability of mortgage credit in general, and to minorities or economically disadvantaged groups, in particular. A prohibition against exercise of a "due-on-sale" clause also tends to perpetuate the existing distribution of mortgage credit in areas that already enjoy an abundance of housing funds while inhibiting lenders from diverting such funds to mortgage-deprived areas.

Finally, the inclusion of a choice of law clause in the standardized loan document, specifying the application of the law of the jurisidiction, cannot be read to imply anything with respect to a waiver by a federal association of federal law authorizing the use of a "due-on-sale" clause or acquiescence by the Bank Board in the application of conflicting state law.

III.

ARGUMENT

The Bank Board, as the agency charged by Congress with the responsibility for prescribing the lending practices of federal associations, has made a policy determination regarding a particular lending practice of federal associations. It has determined that the use of "due-on-sale" clauses, *inter alia*, for the purposes of adjusting interest rates is an appropriate lending practice, and has formalized that determination in explicit regulations.

If the regulations of the Bank Board are valid then they must be given effect. Most arguments regarding the validity of the regulations, however, become inextricably intertwined with arguments attacking the wisdom of the Bank Board's policy determinations.[1]

In giving effect to the regulations of the Bank Board, this Court obviously need not endorse the Bank Board's policy determinations. Indeed, as a matter of jurisprudence, this Court should give effect to the regulations even if it were convinced that the policies upon which they were based were as unwise or pernicious as is suggested by the opponents of the regulation. Nevertheless, in light of what has transpired in the California courts, the American League deems it appropriate to emphasize that the policy determination of the Bank Board is wholly rational, prudent, and fair.

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[1] To illustrate, note that California law does not invalidate "due-on-sale" clauses *per se;* nor does it invalidate restraints upon alienation *per se.* Instead, California law invalidates only "unreasonable" restraints upon alienation, and in *Wellenkamp* the California Supreme Court explicitly determined that exercising "due-on-sale" clauses for the purpose of adjusting interest rates was unreasonable.

Thus, the ultimate issue herein is whether the California Supreme Court, on the one hand, or the Bank Board, on the other, has the authority to determine whether a particular lending practice of federal associations is reasonable.

A. AN ENFORCEABLE "DUE-ON-SALE" CLAUSE CONTRIBUTES TO THE WIDER AVAILABILITY OF MORTGAGE CREDIT.

1. The Ability to Exercise the "Due-On-Sale" Clause for the Purpose of Adjusting Interest Rates Contributes to the Availability of Mortgage Credit to Minorities and Other Economically Disadvantaged Groups.

A policy of limiting the exercise of "due-on-sale" clauses has, at least superficially, the appearance of advancing the interests of consumers generally. In fact, however, and as the Bank Board and other students of the mortgage market have recognized, the opposite is true. The policy of permitting the exercise of "due-on-sale" clauses for the purpose of adjusting interest rates best serves the interests of consumers generally, and economically disadvantaged consumers in particular, by contributing to the greater availability of mortgage credit.

Most fundamentally, an exercisable "due-on-sale" clause permits a lender to make a loan at a lower interest rate.

A "due-on-sale" clause is, fundamentally, a device for determining the duration of an extension of mortgage credit. Its exercise effectively limits the life of a loan to the period in which the borrower retains ownership of the property. A lending institution, performing its function of credit intermediation, recognizes that the property will probably be sold periodically (homes in this country are in fact sold approximately once every seven years, on the average) and it therefore has assigned a price to an extension of credit based upon that assumption.[2]

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[2] It follows, therefore, that if lenders had foreseen the subsequent invalidation of "due-on-sale" clauses, they would not have made the same loans that were actually made in the past at the same interest rate based upon an assumption that the "due-on-sale" clause was exercisable. See also footnote 5, *infra*.

The State of California has effectively declared, however, that lenders cannot limit the duration of an extension of credit to the period during which its customer retains ownership of the property. The lender is, accordingly, left with a choice among various options:

1. It can make a loan with a fluctuating interest rate (assuming that it is otherwise authorized to do so); or

2. It can make a loan with fixed rate and a relatively short fixed term, such as for one, three, or seven years, and little or no amortization of principal; or

3. It can make a "classic" 30-year, fixed rate loan — *but only at an interest rate higher than it would charge for the same loan with an enforceable "due-on-sale" clause.*[3]

There are a host of potential borrowers in this country, however, to whom none of the above-listed options is as attractive or as economically feasible as a "classic" 30-year, fixed-rate loan with an exercisable "due-on-sale" clause.

Consider, for example, the situation of borrowers with fixed incomes, or with incomes that are unlikely to increase in the future. These borrowers would presumably want to avoid loans

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[3] The greater risks of interest rate fluctuations faced by the lender making a long-term, fixed rate loan without an enforceable "due-on-sale" clause is but one factor that will force the lender to charge a higher interest rate for such a loan.

Under present California law, for example, a lender can utilize a "due-on-sale" clause only if the lender can prove that the transferee of the property represents a risk of waste or default. Therefore, when transfers occur a lender will have to choose to either (1) incur the costs of investigating the creditworthiness and reliability of a stranger who has no incentive to cooperate with a lender, or (2) forego any investigation and incur the costs of default or waste when they occur. Either choice entails an unavoidable additional cost that must be reflected in the interest rate of the loan.

with payments that are likely to increase, or loans that might have to be renegotiated in the near future, and hence would find either of the first two options listed above unattractive and possibly infeasible. The third option may be equally unsatisfactory, for the added incremental cost of a "classic" 30-year, fixed rate loan without an enforceable "due-on-sale" clause will make the loan unaffordable by some who could have afforded the same loan if it had included an enforceable "due-on-sale" clause.[4]

For these and for related reasons, a number of courts that have recently considered the issue have explicitly repudiated the policy determination arrived at by the California Supreme Court in *Wellenkamp*.

As the Nebraska Supreme Court, for example, observed in *Occidental Savings & Loan Association v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843, 847 (1980):

> "While the immediate result obtained by the California court may seem to be in the best interest of everyone except the lender, one need only give some careful thought to the results which must flow from such a decision to recognize that whatever relief may be provided for the seller is momentary and fleeting. Decisions such as *Wellenkamp* place an unreasonable burden upon lenders and call upon courts to act as periodic arbitrators in the sale of real estate.

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[4] To many potential borrowers from American League members, the ownership of their own homes is the goal of a lifetime. Under California's policy, however, these borrowers may be forced to purchase along with their homes a "tied" valuable asset in the form of a marketable (*i.e.*, assumable) loan. To those for whom the acquisition of such an asset is a secondary consideration or no consideration at all, California's policy with regard to "due-on-sale" clauses is extremely unfair.

"If any market hindrance imposed by the lender can be held to be a practical restraint on alienation and therefore, invalid, no solution to varying market conditions can ever be validated and, ultimately, no one will be able to secure satisfactory financing."

Similarly, as noted by the Massachusetts Supreme Court in *Dunham v. Ware Savings Bank*, ... Mass. ....., 423 N.E. 2d 998, 1004 (1981):

"Invalidation of the due-on-sale clause would have an immediate, concrete, and unfair impact upon the interests of future borrowers because the interest rate for their mortgage loans would have to be sufficiently high to offset the bank's loss from outstanding low-interest loans which could then be prolonged through assumption. Viewed from this perspective, the issue thus becomes whether future borrowers who borrow from the bank *through assumption of outstanding low-interest mortgages* should be entitled to subsidization by those future borrowers who borrow directly from the bank. We perceive no policy reason for imposing such a result." (Emphasis in original.)[5]

[5] The Massachusetts Supreme Court has recognized, as have others, that lenders who made currently outstanding loans on the assumption that "due-on-sale" clauses were exercisable (as is the case for any federal association that relied upon the Bank Board's regulation) will be forced, if they are to stay in business, to recoup their losses on these old loans by charging incrementally higher interest rates on new loans. 423 N.E. 2d at 1004. Therefore, new entrants to the housing market will be forced to subsidize those with older loans, while those "owning" such older loans will receive windfalls in the form of the valuable marketability of those loans for which they did not bargain, and for which they did not pay. (Moreover, because one "change of the game rules" encourages others, rational lenders will demand an additional premium in the form of a higher interest rate to protect against the risk of future court decisions that retroactively lower the value of their investments after they are made.) Inasmuch as minorities and economically disadvantaged groups are more likely to be potential entrants to the housing market than "owners" of older loans, an invalidation of "due-on-sale" clauses thus works to their disadvantage.

In the same vein is the decision of the Texas Court of Civil Appeals in *Crestview, Ltd. v. Foremost Insurance Co.*, 621 S.W.2d 816, 824 (Tex.Civ.App. 1981):

> "We note in the beginning that it is incongruous that a 'due on sale clause' of the kind here in issue is attacked on the ground that it inhibits alienation and frustrates the public policies favoring the free alienation of property, for the clause normally arises as part of an agreement wherein the maker and payee of a note have agreed to defer payment of a large part of the purchase price of a parcel of property *in order to accomplish its alienation.* Such a financial arrangement operates intrinsically to facilitate, and not inhibit, the free alienation of real property and acts directly to serve the public policies relied upon to justify in the first instance the rule against unreasonable restraints. In contrast, if a 'due on sale clause' may lawfully operate only when the noteholder's security would be impaired, we should think that the result would be to deter sellers and lenders from committing themselves to long-term, deferred-payment arrangements with purchasers, except at higher rates of interest, higher purchase prices, or higher initial cash payments, all of which would tend to discourage the sale and alienation of real property, thereby subverting the pertinent public policies sought to be served by the rule against unreasonable restraints." (Emphasis in original.)

Similarly, as the United States Court of Appeals for the Fourth Circuit, interpreting Virginia law in *Williams v. First Federal Savings & Loan Association of Arlington*, 651 F.2d 910, 924 n.29 (1981), observed:

> "It is simply a misperception to eviscerate, as the California majority in *Wellenkamp* appears ready to eviscerate, as a restraint on alienation, a clause that only

precludes the homeowner from realizing an additional and unbargained for economic advantage because interest rates have risen since the time when he secured, by mortgage or deed of trust, his promise to repay what he borrowed."[6]

For the foregoing reasons, the ability to exercise the "due-on-sale" clause for the purpose of adjusting interest rates tends to reduce the costs of mortgage borrowing to the consumer and thereby contributes to the availability of mortgage credit to minorities and other economically disadvantaged groups.

2. Prohibiting the Exercise of a "Due-On-Sale" Clause Tends to Perpetuate the Existing Distribution of Mortgage Credit and Inhibits the Diversion of Such Funds to Mortgage-Deprived Areas.

It is the policy of the Bank Board to prevent illegal discrimination in lending as well as the practice of "redlining" — credit discrimination based upon the characteristics of the neighborhood surrounding the property.[7] Moreover, in order to overcome, *inter alia*, the present effects of past credit discrimination, both the Community Reinvestment Act, 12 U.S.C. §§2901-2905 ("CRA") and the Equal Credit Opportunity Act, 15 U.S.C. §1691, *et seq.* ("ECOA"), effectively mandate federal associations, under the regulatory supervision of the

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[6] The Fourth Circuit in *Williams* recognized that the preemptive effect of HOLA and the regulations of the Bank Board could potentially serve as an alternative basis for its decision. It found it unnecessary to base its decision upon preemption, however, because it first concluded that the exercise of the "due-on-sale" clause was proper under state law. To the same effect is the decision of the New Hampshire Supreme Court in *Mills v. Nashua Federal Savings & Loan Association*, ... N.H. ..... , 433 A.2d 1312 (1981).

[7] In *Conference of Federal Savings & Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.* 445 U.S. 921 (1980), this Court affirmed a decision of the Ninth Circuit holding that HOLA and the regulations of the Bank Board preempted the application of California's "fair lending" laws to federal associations.

Bank Board, to distribute — or more precisely, redistribute — their mortgage loan funds in accordance with the objectives and criteria that they prescribe.[8]

The ability of federal associations and the Bank Board to accomplish such a redistribution of mortgage funds is severely lessened, however, if "due-on-sale" clauses are not exercisable.

More particularly, every transfer of title to property that is hypothecated by a mortgage containing an enforceable "due-on-sale" clause affords the lender the ability to determine whether or not the funds should be recommitted to the same property or placed elsewhere. The invalidation of the "due-on-sale" clause, however, makes it impossible for federal associations to exercise any material control over the reallocation of their mortgage funds. Thus, billions of dollars of mortgage credit that would otherwise be subject to periodic reallocation upon transfer of title is "locked in" to the properties upon which the original loans were made. Because the existing distribution of mortgage credit may reflect past "redlining" and other discriminatory lending practices, the invalidation of the "due-on-sale" clause makes it impossible for lenders to direct mortgage credit away from areas which already enjoy an abundance of housing funds to areas which have been deprived of such funds in the past. Furthermore, unless the individuals who "own" the original loans undertake

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[8] Under CRA for example, the Bank Board is authorized to take into account the lending record of a federal association, including its service to low- and moderate-income neighborhoods, in evaluating an application by a federal association for a deposit facility, including applications for branch offices, remote electronic service units, office location changes, mergers, consolidations, reorganizations, and holding company acquisitions, among others. The possibility of denial by the Bank Board of such applications for poor lending performance in low- and moderate-income neighborhoods, which often are also minority neighborhoods, is a powerful incentive to a federal association to work to overcome the effects of past redlining. The Bank Board's regulations implementing the Community Reinvestment Act appear at 12 C.F.R. Part 563e.

voluntarily not to discriminate on the basis of an impermissible characteristic, past lending practices and credit distributions are further perpetuated.[9]

Thus, despite the requirements of the CRA and the ECOA, the implementing regulations of the Bank Board, and the efforts of American League members and federal associations alike to allocate mortgage credit on a non-discriminatory basis, the invalidation of the "due-on-sale" clause totally frustrates the ability of federal associations to reallocate these "locked in" funds in any fashion. In summary, prohibiting the exercise of "due-on-sale" clauses will tend to perpetuate existing distributions of credit and frustrate federal law specifically designed to achieve a more equitable distribution.

B. THE LANGUAGE OF THE CHOICE OF LAW CLAUSE CONTAINED IN THE STANDARDIZED LOAN DOCUMENTS DOES NOT AFFECT THE BANK BOARD'S AUTHORIZATION PERMITTING FEDERAL ASSOCIATIONS TO EMPLOY AND EXERCISE "DUE-ON-SALE" CLAUSES.

The within appeal involves a mortgage loan contract that uses standardized instruments widely employed by both the Federal National Mortgage Association ("FNMA") and the Federal Home Loan Mortgage Corporation ("FHLMC"). In addition to containing a "due-on-sale" clause, this instrument contains a choice of law clause providing as follows:

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[9] Not only are members of racial or ethnic minority groups harmed by this perpetuation of past credit practices but younger, new entrants into the housing market generally, who might be seeking housing in modest neighborhoods, are disadvantaged as well. In many instances, such neighborhoods have not in the past enjoyed the same abundance of available mortgage credit as have more affluent neighborhoods.

"This form of deed of trust combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Deed of Trust or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Deed of Trust or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Deed of Trust and the Note are declared to be severable."[10]

The Appellees have argued that the effect of this clause is to specify that state law shall apply and thereby effect a waiver of federal law. The argument is plainly invalid. Aside from anything else, federal law is as much a part of the law of the State of California as if it had been enacted by the California legislature itself. As this Court explained in *Hauenstein* v. *Lynham*, 100 U.S. 483, 490 (1880):

"It must always be born in mind that the Constitution, laws, and treaties of the United States are as much part of

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[10] Joint FNMA/FHLMC uniform mortgage instruments containing a "due-on-sale" clause and a choice of law clause identical to those at issue herein were first adopted in June, 1975. FHLMC will not purchase a conventional mortgage originated after January 1, 1976 unless that mortgage was originated using the standardized FNMA/FHLMC instruments.

Between 1971 and June, 1975, FHLMC and FNMA used separate sets of uniform instruments. The FHLMC instruments contained a "due-on-sale" clause and a choice of law clause, the FNMA instruments used between 1971 and June, 1975, contained a choice of law clause but not a "due-on-sale" clause. However, FNMA would purchase mortgages originated on the FHLMC uniform instruments in this period and many lenders selling to FNMA included "due-on-sale" clauses in their deeds of trust or mortgages.

> the law of every State as its own local laws and Constitution. This is a fundamental principle in our system of complex national policy." [11]

Accordingly, the waiver argument must be rejected, and indeed, was not accepted by the Court of Appeal.[12]

In addition, the Court of Appeal, focusing on the provision, decided that "such language expresses an unmistakable intention that state law shall govern interpretation, validity, and enforcement of the loan-security instrument" (J.S. App. 19a), and then proceeded to conclude that such an intention existed on the part of the Bank Board regardless of whether the particular language of the choice of law provision was incorporated into the contract or not. Thus, in rejecting the conclusion that federal law had preempted state law with respect to the loan contract before it, which did not include such a provision, the Court of Appeal observed as follows:

> "We recognize that the deed of trust here involved does not contain a provision such as that found in the other two deeds of trust to the effect that it shall be governed by the law of the jurisdiction in which the property is situated.

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[11] The California Supreme Court has recognized and applied the foregoing principle. See *People ex rel. Happell* v. *Sischo*, 23 Cal.2d 478, 490, 144 P.2d 785, 791-792 (1953) ("[t]he Constitution of the United States and all laws enacted pursuant to the powers conferred by it on the Congress are the Supreme law of the land (U.S. Const. art. VI, cl. 2) to the same extent as though expressly written into every state law").

[12] The Appellees' waiver argument is not, of course, confined to the area of "due-on-sale" clauses; it would apply to all aspects of federal law affecting the contract. Giving the language this effect would permit federal savings and loan associations to evade federal law in whatever area they found such law to be onerous or inconvenient.

Even if the phrase "law of the jurisdiction" could be interpreted in this manner, federal savings and loan associations could not effectively enter into such a waiver. See generally *Scott Paper Co.*v. *Marcalus Manufacturing Co.*, 326 U.S. 249, 255-257 (1945); *Brooklyn Savings Bank* v. *O'Neil*, 324 U.S. 697, 704-705 (1945).

> However, our conclusion in the Moore case was not based so much on an agreement between the parties for the application of state law as on the conclusion that the *general use of a provision containing such language* by federal savings and loan associations with the approval of the Board *persuasively evidences a recognition by the Board* and federal savings and loan associations *that state law would govern* the interpretation, validity and enforcement of security instruments. *Thus, the absence of the special provision in the particular trust deed, here, is of no great significance to our resolution of the preemption issue.*" (J.S. App. 23a-24a, emphasis added.)

The reasoning of the Court of Appeal is nonsensical. To begin with, even assuming, *arguendo*, that the presence of this language suggests that the Bank Board might not have intended to preempt state law, any such conclusion would be flatly contradictory to the earlier explicit acknowledgement of the Court of Appeal that "the *Board* has manifested *its* unqualified intention that [its regulations] relating to due-on-sale clauses shall occupy a preemptive position over conflicting state law provisions." (J.S. App. 15a, emphasis in original.) Given the existence of such a manifestation of the unqualified intent of the Bank Board, of what possible significance is the fact that the language of the choice of law provision (or, for that matter, any other part of the loan instrument) arguably could have, but did not, reinforce that manifestation?

Furthermore, the language is *not* evidence of any intent regarding the applicability of federal law — it is simply neutral on the subject. Whatever the "law of the jurisdiction" may be, it is fundamental that such law includes federal law. See, e.g., *Hauenstein* v. *Lynham*, *supra*.

Obviously, the choice of law clause in the standardized FNMA/FHLMC loan documents was designed to clarify the point that the law of the state where the property is located will apply in those areas that have been left to state law by the federal regulatory scheme, as, for example, marital property rights or inheritance laws. The clause is irrelevant, however, to the determination of the content of federal law that is at issue herein.

IV.

CONCLUSION

The decision of the California Court of Appeal herein should be reversed.

Respectfully submitted,

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IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

REGINALD D. DE LA CUESTA, *et al.*,

Appellees.

On Appeal from the California Court of Appeal
Fourth Appellate District

Brief of Charles J. Bether and Edna M. Bether as Amici Curiae in Support of Appellees

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No. 81-750

IN THE

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FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

REGINALD D. DE LA CUESTA, *et al.*,

Appellees.

Brief of Charles J. Bether and Edna M. Bether as Amici Curiae in Support of Appellees

PRELIMINARY STATEMENT

Charles J. Bether and Edna M. Bether submit this brief *amicus curiae* in support of the Appellees in this proceeding. All parties to this proceeding have given their written consent to the filing of this brief. Copies of such written consents have been filed with the Clerk of this Court.

INTEREST OF AMICI CURIAE

Amici are borrowers from Glendale Federal Savings and Loan Association, a federally chartered savings and loan association located in California. *Amici* are the plaintiffs in an action in the Superior Court of the State of California for the County of Los Angeles entitled *Charles J. Bether, et al. v. Glendale Federal Savings and Loan Association,* L.A.S.C. No. CA 545, wherein, on behalf of themselves and others similarly situated, *amici* have sought a determination that the defendant may only exercise the "due-on-sale" clause in its deeds of trust under the circumstances permitted in *Wellenkamp v. Bank of America,* 21 Cal.3d 943, 148 Cal.Rptr. 379, 582 P.2d 970 (1978). The interests of *amici,* and those they represent, would be directly affected by the outcome of the present proceeding.

SUMMARY OF ARGUMENT

Amici recognize that many briefs have been filed in this proceeding, and we would not suggest that this Court requires yet another point-by-point discussion of every issue involved. The present brief will therefore be limited to two issues which, in our view, warrant more consideration than has been given in the briefs filed to date.

The first such issue is whether Congress has delegated to the Federal Home Loan Bank Board (the "Bank Board") the authority to promulgate the regulation in question (12 C.F.R. §545.8-3(f)). Appellants have made much of whether there is any distinction between the Bank Board's authority to regulate the "internal" and "external" affairs of federally chartered savings and loan associations. A more important question, we suggest, is not what the Bank Board may regulate, but *whom* it may regulate. By this regulation, the Bank Board has purported to deprive unregulated parties—borrowers—of rights guaranteed by state laws of real property. The legislative history of the Home Owners' Loan Act indicates no intention to grant the Bank Board the power to thus control the legal rights

of those it does not have the authority to regulate, and there is no proper basis for construing the Congressional delegation of authority as empowering this bank regulatory body to deprive third parties of state-created rights.

The second issue which *amici* wish to discuss relates to the extent to which the rights of the parties can properly be decided in the procedural context of this case. This Court's decision as to whether the Bank Board has superseded California real property law will not necessarily determine the rights of the parties. The Bank Board regulation here involved only provides that the terms of the mortgage contracts will govern. It has not been established that the contracts themselves permit an automatic exercise of the due-on-sale clause. If the Bank Board regulation were held to supersede state law, the cases must still be remanded to determine whether, as a matter of contract interpretation, Appellants were entitled to accelerate the loans.

ARGUMENT

I.

CONGRESS DID NOT DELEGATE TO THE BANK BOARD THE AUTHORITY TO DEPRIVE NON-REGULATED PARTIES OF RIGHTS GUARANTEED BY STATE LAWS OF REAL PROPERTY.

The question addressed here is whether, by the general language of §5 of the Home Owners' Loan Act (hereinafter "HOLA") [12 U.S.C. §1464], Congress intended to delegate to three bank regulators the authority to rewrite the law of real estate developed over centuries,[1] and thereby deprive literally

[1] The decision of the Court of Appeal in this case was based upon California Civil Code § 711. However, the principle enunciated by § 711—the free alienability of real property—is one which has existed at least since the thirteenth century. In 1290, the statute of *Quia Emptores* (Stat. 18 Edw. I) declared that every free man might sell his tenement or any part of it. F. Pollock & F. Maitland, *The History of English Law* 337 (2d Ed. (reissued)

(Footnote continued on following page)

millions of borrowers of those protections which they have been guaranteed by state law. We shall conclude that Congress gave the Bank Board no authority to deprive non-regulated parties of their state-created rights and, therefore, that the judgment of the Court of Appeal should be affirmed.[2]

Our argument will be made in two stages. First, we shall examine the legislative history of HOLA to determine whether there is any support for the extraordinary construction of HOLA now being urged by Appellants. Failing to find such

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(Footnote continued from preceding page)
1968). The doctrine is hardly one invented by a recent generation of "consumer advocates"; it has been a part of the common law almost from the inception of the common law. The *amicus* brief filed on behalf of the United States League of Savings Associations and others (the "U.S. League Brief") attempts to argue that a due-on-sale clause is not really a restraint on alienation. U.S. League Brief, fn. 4 at p. 5. In fact, the due-on-sale clauses here involved fall directly within the U.S. League's definition of a "promissory restraint". In two of the three deeds of trust involved in this proceeding, the transfer of the property is specifically described as an event of default. Jt.App. 24, 103. In the third deed of trust, transfer is not expressly described as an event of default, but the lender's remedies are identical to those available to it on default. Jt.App. 68-69.

[2] The Bank Board's 1976 regulation (12 C.F.R. § 545.8-3(f)) is the only basis for a finding of preemption. Although some portions of the *amicus* brief of the Federal Home Loan Bank Board and the Federal Home Loan Mortgage Corporation (the "Bank Board Brief") appear to imply that preemption could be based upon a need for "uniformity" in applying the FNMA/FHLMC Uniform Instruments [see Bank Board Brief, pp. 3-4, 24-25], it is clear that such is not the case. In fact, a finding of preemption would destroy uniformity, not preserve it. As the Bank Board recognizes, the only basis for avoiding the application of state law to the Uniform Instruments is to interpret the "law of the jurisdiction" provision in Uniform Covenant 15 as including the 1976 regulation. However, the 1976 regulation is, by its terms, applicable only to federally chartered savings and loans, while the FNMA/FHLMC Uniform Instruments are used by numerous state chartered lenders. See *FHLMC Sellers' Guide-Conventional Mortgages* §§ 1.208, 1.213, 1.221, 1.407; 12 U.S.C. § 1454(a)(1). Appellants' construction of the Uniform Instruments would thus apply only to some of the lenders who use them. If preemption is found here, the Uniform Instruments will have different applications—even within a single state—depending upon the identity of the originating lender. The FHLMC may call this "uniformity"; we suggest that "chaos" is a more appropriate description.

support, we shall discuss applicable legal principles concerning the authority of federal regulatory bodies and explain that the authority of federal regulatory bodies does not ordinarily extend to controlling the legal rights of those whom they have not been authorized to regulate. We shall conclude that this general rule is particularly appropriate in the instant case because of the nature of the rights involved and the massive disruption of the federal-state balance which would result if Appellants' position were accepted.

A. The Legislative History of HOLA Gives No Indication that Congress Intended to Authorize the Bank Board to Deprive Borrowers of Rights Granted by State Laws Concerning Real Property.

The legislative debates on the passage of HOLA, and the context in which it was passed, offer no support for Appellants' expansive view of the purposes of HOLA.[3] The purpose of Congress in authorizing the creation of federally chartered

[3] We shall here discuss the passage of HOLA in 1933. The Bank Board has quoted certain statements made by a few Congressmen in 1978. Bank Board Brief, pp. 14-15. However, "the views of one Congress as to the construction of a statute adopted many years before by another Congress have 'very little, if any, significance.'" *United States v. Southwestern Cable Co.*, 392 U.S. 157, 170 (1968) (quoting *Rainwater v. United States*, 356 U.S. 590, 593 (1958)). The statements quoted by the Bank Board are, of course, taken from context; they related to an irrelevant amendment dealing with the continued authority of state regulatory bodies over converted mutual savings banks. Indeed, the Bank Board's quotation from Senator Brooke [Bank Board Brief, p. 15] is quite revealing. The statement occurred in a colloquy with Senator Proxmire. In a brief in a different case, the Bank Board quoted Senator Proxmire's portion of the colloquy (saying essentially the same as Senator Brooke's) in support of its views on preemption. Senator Proxmire immediately disavowed any such meaning, asserting that the Bank Board's use of his statement to support its preemption argument "misinterprets the basis and intent of my remarks." 125 Congressional Record, pp. S2165-2166 (March 7, 1979). The Bank Board now quotes Senator Brooke's portion of the colloquy, apparently on the assumption that Senator Brooke meant something different in talking to Senator Proxmire than Senator Proxmire meant in talking to Senator Brooke.

savings and loan associations was a limited one; Congress did not intend to create a class of lenders enjoying special privileges, but only to create more lenders in those areas not served by state chartered lenders. There is every indication that Congress intended that state law would apply to their contracts with borrowers, and there is no indication that Congress authorized the Bank Board to grant them special privileges *vis a vis* borrowers, or special competitive advantages in relation to their state chartered counterparts.[4]

HOLA was passed by Congress in 1933 at a time when many homeowners were facing foreclosure because they were unable to make their mortgage payments. The stated purpose of HOLA was to "provide emergency relief with respect to home mortgage indebtedness, to refinance home mortgages, to extend relief to the owners of homes occupied by them and who are unable to amortize their debt elsewhere. . . ." Preamble to HOLA, 48 Stat. 128 (1933). Congress sought to accomplish these purposes in two ways. First, it would provide immediate relief to home owners facing foreclosure. Second, it would pump additional money into the mortgage lending industry.

The first (and principal) purpose was to be accomplished through the creation of the Home Owners' Loan Corporation ("HOLC"). HOLC was created by §4 of HOLA [formerly 12 U.S.C. §1463, since repealed] to acquire existing mortgages (principally those in default) and to refinance them on liberal payment terms.

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[4] Indeed, Mr. Stevenson of the Bank Board was specifically asked whether federally chartered savings and loans would "have any more advantages or authority than the present savings [and] loan associations have." His response was "No, sir." *Hearings on H.R. 4980 Before the House Committee on Banking and Currency*, 73rd Cong., 1st Sess. 17-18 (April 20, 1933) (hereinafter "*House Hearings*"). However, if Appellants' position is upheld, federally chartered savings and loan associations will occupy an exalted status among lenders. All other private lenders in America will be governed by one set of rules in their dealings with borrowers, while federally chartered savings and loans will be governed by a different set of rules. The rights of a borrower will vary depending upon the happenstance of whether he borrowed from the state chartered savings and loan on the corner, the bank next door, or the federally chartered savings and loan down the block.

The framework for the second purpose—the infusion of liquidity into the morgage market—had been created the previous year by the Federal Home Loan Bank Act, 12 U.S.C. §§1421 *et seq.* The Home Loan Bank Act had established a system of twelve regional Federal Home Loan Banks (modeled on the Federal Reserve Banks) funded initially by the federal government through its purchase of stock. These Home Loan Banks were created to provide funds for mortgage financing by advancing funds to mortgage lenders against the security of home mortgages.[5]

While the framework already existed, the mortgage lenders did not. The Home Loan Bank Act contemplated that savings and loan associations and savings banks would be the vehicles through which federal money would be pumped into the mortgage market.[6] However, Congress had discovered that large portions of the country were not served by any savings and loan associations or savings banks. *Hearings on S. 1317 Before a Subcommittee of the Senate Committee on Banking and Currency,* 73d Cong., 1st Sess., 19-20 (April 20 and 22, 1933) (hereinafter "*Senate Hearings*"). The Federal Home Loan Bank system could not perform its function in these areas because there were no mortgage lenders to receive the funds which Congress had made available. Thus, Representative Luce stated, in introducing the bill in the House:

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[5] The theory of the Federal Home Loan Banks was similar to that of the economic "multiplier". Mortgage lenders would borrow funds from the Home Loan Banks against existing mortgages. They would take those borrowed funds and make mortgage loans. These new mortgages would provide security for additional loans from the Home Loan Banks, the proceeds of which would, in turn, be used to make additional mortgage loans.

[6] See 12 U.S.C. § 1424(a). Commercial banks were not eligible for membership in the Home Loan Bank system.

> "There are in this country 3,072 counties. There are 1,566, almost exactly half, that have no building and loan associations, no mutual savings bank, and no insurance company, and therefore cannot benefit by the provisions of last year's law." 77 Cong. Rec. 2480 (April 27, 1933).[7]

The legislative history of HOLA reveals that the only stated purpose for the creation of federally chartered savings and loan associations was to create mortgage lenders in areas where none then existed. This purpose is stated by the House Committee Report:

> "The bill also provides for the Board to charter Federal savings and loan associations in communities now insufficiently served by any institution or other lender on homes, so that provision may be made for the financing of homes in more than 1,500 counties in the United States now having no such facilities." *House Committee Rept.* 2.

In response to the question as to whether "it is an absolute necessity to form additional savings and loan associations," Representative Goldsborough explained why the bill provided for their creation:

> "If a county has no organization whatever to loan money, the gentleman knows, probably as well as or better than I, that it is almost impossible to get money from a bank at this time. It was on this theory that these associations were authorized to be set up." 77 Cong. Rec. 2486 (April 27, 1933).

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[7] To similar effect, see *Report of the House Committee on Banking and Currency* (H.R. Rept. No. 55) 73d Cong., 1st Sess. 2 (April 25, 1933) (hereinafter "*House Committee Rept.*"); *Report of the Senate Committee on Banking and Currency* (Sen. Rept. No. 91) 73d Cong., 1st Sess. 2-3 (May 15, 1933) (hereinafter "*Senate Committee Rept.*"); Statement of Rep. Steagall (Chairman of the House Committee), 77 Cong. Rec. 2477 (April 27, 1933).

This constant theme—creating more mortgage lenders—appears throughout the legislative history.[8] *No other purpose was ever stated by any Congressman or Committee.* There was no suggestion (not even a hint) in any committee report, or in the floor debates, that HOLA was enacted, or federally chartered savings and loan associations would be created, to solve alleged problems caused by a supposed "hodgepodge of savings and loan laws and regulations"[9] or "pernicious state practices" or the supposed "failings of the existing state-controlled home financing system."[10] If these purposes did exist, they were a well-kept secret. Indeed, the Federal Home Loan Banks had, in less than a year, committed to advance $97,000,000 to this "hodgepodge" of state chartered lenders (presumably so that they could continue making "pernicious" types of loans)[11] and the few references in the

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[8] See the *Senate Committee Report* 2; the statement of Representative Steagall introducing the legislation in the House [77 Cong. Rec. 2477 (April 27, 1933)]; statement of Senator Bulkley introducing the legislation in the Senate [77 Cong. Rec. 4974 and 4975 (June 5, 1933)]; statement of Representative Luce [77 Cong. Rec. 2480 (April 27, 1933)]; *Senate Hearings* 8 [statement of Mr. Russell of the Bank Board]; *House Hearings* 14-15 (April 21, 1933) [Statement of Mr. Stevenson of the Bank Board].

[9] The Bank Board Brief (at pp. 11-12) purports to cite page 8 of the *Senate Hearings* in support of its assertion that Congress enacted HOLA as a reaction to this "hodgepodge" which supposedly "had crippled the ability of thrift institutions to provide home-financing." Nothing in the cited reference even arguably supports this statement.

[10] These latter two quotations are from pp. 10-12 of the U.S. League Brief. Needless to say, the U.S. League Brief gives absolutely no citation to the legislative history to support any of these supposed "purposes". Similarly, Appellants assert the existence of various Congressional "purposes" for HOLA, all without reference to a single Congressman or committee ascribing to those "purposes". Appellants' Brief, pp. 12-13, 35. The reason, of course, is that the legislative history is devoid of support for the "purposes" asserted.

[11] See *Hearings on S. 6 Before a Subcommittee of the Senate Committee on Banking and Currency*, 73d Cong., 1st Sess. 9 (March 22, 1933). Mr. Russell of the Bank Board testified that the purpose of the Home Loan Bank Act was to provide these state chartered savings and loans (the only ones which then existed) with a place "where they could get the money to continue their work." *Id* at p. 5.

Congressional debates to state chartered savings and loans somehow failed to mention the supposed inadequacies in their methods of operation.[12]

In enacting HOLA, Congress gave no indication that it intended to create a specially sheltered class of lender. Rather, its stated purpose in providing for the creation of federally chartered savings and loans was to create more mortgage lenders in order to act as vehicles to provide Federal Home Loan Bank money to those portions of the nation which were not served by state chartered mortgage lenders. These new private mortgage lenders were intended to supplement the existing system of state chartered institutions, and the principal function they were to serve — funneling Home Loan Bank money to homeowners — was the same function already being served by state chartered savings and loans where they existed.[13] This was the stated reason—the only stated reason—why §5 (a) of HOLA [12 U.S.C. §1464(a)] provided for the creation of federally chartered savings and loans. The provisions of HOLA are consistent with this purpose. Since the intent of Congress was to establish mortgage lenders in those areas lacking them, §5(e) of HOLA [12 U.S.C. §1464(e)] provided that federal savings and loans could only be chartered if "a necessity exists for such an institution in the community to be served. . . ." And because the function of these institutions was to act as intermediaries between borrowers and the Federal Home Loan Banks, Congress required in §5(f) [12 U.S.C. §1464(f)] that all such institutions must be members of the Federal Home Loan Bank system it had created the preceding year.

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[12] Thus, Senator Bulkley stated [77 Cong. Rec. 4975 (June 5, 1933)] that one reason why HOLA provided for repeal of a provision of the Home Loan Bank Act permitting Home Loan Banks to make direct loans to homeowners was that existing savings and loan associations (*i.e.*, state chartered savings and loans—the only ones which existed at the time) "have handled the business much more satisfactorily than the Home Loan Board felt that it was possible for the home-loan banks to handle it."

[13] Mr. Stevenson of the Bank Board told Congress that federally chartered savings and loans were "to run parallel with the building and loan

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While Congress did not expressly state what law would apply to the mortgage instruments of these newly-authorized institutions, there is every indication that Congress expected and intended that the mortgage instruments of federally chartered savings and loans would be governed by state law. After all, these institutions were intended to be purely private business organizations performing the same functions as existing state chartered institutions. Moreover, at the time HOLA was enacted, Congress was not writing on a clean slate; the federal government had been chartering national banks since the National Bank Act of 1863, and Congress was legislating against the background of seventy years of experience with federally chartered financial institutions.[14] Congress clearly drew on that experience. The parallels between the twelve regional Federal Home Loan Banks and the twelve regional Federal Reserve Banks are too obvious to leave any question. And one commentator has stated that the concept of federal savings and loans "was copied from the national banks. . . ." T. Marvell, *The Federal Home Loan Bank Board* 25 (1969). From its experience with national banks, Congress knew that (unless it said otherwise) the loan instruments of these new federally chartered lenders would be governed by state law; that proposition had been established with respect to national

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associations that are now in existence" [*House Hearings* 13 (April 21, 1933)] and that their creation was "a supplemental proposition, to supplement the activities" of existing mortgage lenders. *Id.* at 15.

[14] This is, of course, why Congress provided for federal savings and loans to be federally regulated. The U.S. League states that Congress could have provided for state regulation, but this would merely have perpetuated those "pernicious state practices" which the U.S. League has discovered, but Congress never mentioned. See U.S. League Brief, pp. 11-12. The reason for providing for federal regulation seems much more basic. At the time HOLA was passed, Congress had been in the business of chartering financial institutions for seventy years, and the parameters of the dual banking system were well-established and well-known. Congress was simply following the familiar pattern established by seven decades of experience with national banks. This parallel did not go unnoticed. See statement of Senator Bulkley at 77 Cong. Rec. 4987 (June 5, 1933).

banks only seven years after the passage of the 1863 act. *First National Bank of Louisville v. Commonwealth of Kentucky,* 76 U.S. (9 Wall.) 353, 362 (1870).[15]

In light of Congress' long experience with national banks, its silence on the subject of the law which would govern the mortgage instruments of federally chartered savings and loan associations indicated a clear assumption that state law would apply.[16] This assumption is further evidenced by the Congressional requirement that federally chartered savings and loans be members of the Federal Home Loan Bank system, and the expressed intent of Congress that these lenders would be vehicles for channeling Federal Home Loan Bank money into the mortgage market. The means by which Federal Home Loan Bank money was provided to lenders was through advances upon "home mortgages" [See 12 U.S.C. §1430], a term specifically defined in the Home Loan Bank Act as being "such classes of first liens as are commonly given to secure

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[15] "[National banks] are subject to the laws of the State and are governed in their daily course of business far more by the laws of the State than of the Nation. All their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debts, are all based on state law. It is only when the state law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional." *First National Bank of Louisville, supra,* 76 U.S. at 362. To similar effect, see *Anderson National Bank v. Luckett,* 321 U.S. 233, 247-248 (1944); *McClellan v. Chipman,* 164 U.S. 347, 357-359 (1896). Indeed, the California Supreme Court's *Wellenkamp* decision involved a national bank.

[16] Implicitly recognizing the close analogy between national banks and federally chartered savings and loans, the Bank Board attempts to draw a distinction between the two types of institutions because Congress expressly provided that state branch banking laws applied to national banks, but made no such provision with respect to federal savings and loans. Bank Board Brief, p. 12. This only indicates that, when Congress wished to distinguish between national banks and federally chartered savings and loans, it did so by express statute. However, the applicability of state law to loan contracts between national banks and borrowers did not occur by reason of statute, and Congress made no distinction between the two types of institutions in that area.

advances on real estate by institutions authorized under this chapter to become members, *under the laws of the State in which the real estate is located,* together with the credit instruments, if any, secured thereby." 12 U.S.C. §1422(6) (emphasis added).[17] Clearly, Congress expected that state law would apply to the mortgages of federally chartered savings and loans.[18]

Nor is there any indication that Congress intended that the Bank Board could change this result by regulation. While Congress gave the Bank Board broad general authority to issue regulations governing federal savings and loan associations, the legislative history evidences no expectation that the Bank Board's authority in this regard extended any further than the normal authority of a regulatory body over those it regulates.[19]

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[17] Appellants would presumably argue that this express reference to state law includes federal law. See Appellants' Brief, pp. 31-32. In the context of the statutory language, this contention seems more than a bit sophistical. What are the "classes of first liens [which] are commonly given to secure advances on real estate" under federal law? The answer is that there are no such instruments because there is no federal law of real estate. See *Oregon ex rel. State Land Board v. Corvallis Sand & Gravel Co.*, 429 U.S. 363, 378-379 (1977); *United States v. Little Lake Misere Land Co., Inc.*, 412 U.S. 580, 591 (1973); *United States v. Fox*, 94 U.S. 315 (1877); Note, "Federal Common Law," 82 *Harvard L. Rev.* 1512, 1518-1519 (1969).

[18] In fact, this was what occurred. In the four decades following the passage of HOLA, state law—and only state law—was applied to the mortgages of federally chartered savings and loans. See the discussion in *de la Cuesta v. Fidelity Fed. S. & L. Ass'n*, 121 Cal. App. 3d 328, 337, 175 Cal. Rptr. 467 (1981).

[19] The Bank Board Brief refers to various statements in the legislative history indicating that the Bank Board had broad authority to administer HOLA. However, every such statement (to the extent it exists) refers only to the authority of the Bank Board to issue charters and perform the "housekeeping" functions normally assigned to bank regulatory bodies. For example, the Bank Board quotes Rep. Luce as saying that Congress left "such things" to the judgment of the Board. Bank Board Brief, p. 14. The reference to "such things" was to the circumstances under which a state chartered savings and loan might obtain a federal charter. 77 Cong. Rec. 2481 (April 27, 1933). Similarly, the Bank Board's reference to the remarks of Rep. Luce at 77 Cong. Rec. 2480 [Bank Board Brief, p. 14] related to the minimum

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Rather, Congress was simply drawing upon its prior experience with national banks, and intended to grant the Bank Board the same type of authority under HOLA it had granted the Comptroller of the Currency under the National Bank Act. See statement of Senator Bulkley at 77 Cong. Rec. 4987 (June 5, 1933) ["The power we propose to give here is quite similar to the discretion given to the Comptroller of the Currency with respect to chartering national banks."].[20]

The legislative history thus indicates that federally chartered savings and loan associations were intended to perform a limited and interstitial function in the Congressional scheme;

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capital requirements for chartering, and the reference to the *House Hearings* [at Bank Board Brief, p. 6] deals with loan-to-value ratio requirements. The Bank Board's reference to the remarks of Rep. Cellar at 77 Cong. Rec. 2573-2574 (April 28, 1933) [Bank Board Brief, pp. 6, 14] is puzzling, because nothing in Rep. Cellar's remarks even arguably supports the proposition for which they are cited.

[20] The Bank Board argues for a much broader interpretation by quoting from testimony given by Mr. Stevenson of the Bank Board indicating that the Bank Board could, by regulation, impose a mortgage provision restricting homeowners from renting their property. Bank Board Brief, fn. 11 at pp. 13-14. This statement is disingenuous at best. In the first place, Mr. Stevenson *was not talking about loans made by federal savings and loans at all;* he was referring to refinancings to be made by HOLC (the federal agency created under §4 of HOLA). Second, while Mr. Stevenson may have attempted to "ma[ke] clear to Congress" that the Bank Board could accomplish such a result by regulation, Congress did not accept his explanation. Immediately after Mr. Stevenson's statement, Senator Couzens disagreed and said "I doubt that it could be enforced by regulations." *Senate Hearings,* p. 14. Mr. Stevenson made no reply. Third, with reference to sales of property, Mr. Russell of the Bank Board specifically testified that a purchaser could assume the mortgage if the house continued to be owner-occupied:

> "He could, of course, only sell it subject to the mortgage, *but the purchaser could take advantage of that low interest rate that that mortgage carried and of the long terms of that mortgage. . . .* " *Senate Hearings,* p. 14 (emphasis added).

Thus, the Bank Board informed Congress that purchasers would have the right to assume loans and gave no indication that the promised result could be changed by regulation.

they were made necessary only because there was an insufficient number of state chartered mortgage lenders. Congress clearly intended that the mortgages of these newly authorized lenders would be subject to state law, and no portion of the legislative history suggests that Congress authorized the Bank Board to repudiate this intention by regulation.

B. In the Absence of Explicit Congressional Authorization, It Would Be Improper to Hold that the Bank Board Has the Authority to Deprive Unregulated Parties of Rights Granted by State Laws of Real Property.

Having examined the legislative background to HOLA, we shall now directly address the question of whether HOLA authorized the Bank Board to deprive non-regulated parties of the state-created rights here involved. The question is one of statutory construction. The Bank Board "is entirely a creature of Congress and the determinative question is not what the Board thinks it should do but what Congress has said it can do." *Civil Aeronautics Bd.* v. *Delta Air Lines, Inc.*, 367 U.S. 316, 322 (1961).

The Congressional grant of authority in HOLA gives the Bank Board significant regulatory authority over federally chartered savings and loan associations,[21] but grants the Bank Board no regulatory authority over borrowers. The present proceeding involves far more than the "operation" of federal

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[21] The Congressional grant of regulatory authority to the Bank Board is as follows:

> "In order to provide for local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as 'Federal Savings and Loan Associations'... and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States." 12 U.S.C. §1464(a).

Appellants have emphasized the "best practices" language contained in the final clause. Appellants' Brief, pp. 14-15, 19, 35. It should be noted that this language is not part of the Congressional delegation of authority to the Bank Board; it is a standard to be used with respect to the matters which have been delegated.

savings and loan associations. It involves the respective rights of a mortgagee and a mortgagor, *only one of whom is regulated by the Bank Board.* The Bank Board is thus attempting to use its regulatory authority over savings and loan associations (which no one disputes) to abrogate the state-guaranteed rights of a party over whom the Bank Board was given no authority at all.[22] Such an extraordinary attempt at bureaucratic empire-building cannot be supported merely by the ambiguous language of §5(a) of HOLA. We submit that no portion of HOLA gives the Bank Board the authority to selectively rewrite state laws of real property and thereby abrogate the rights of those it has not been authorized to regulate. If the state-guaranteed rights of borrowers are to be denied, such action must come from Congress, not the Bank Board.[23]

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[22] *Amici* do not dispute the authority of the Bank Board to promulgate regulations stating what provisions may or may not be included in lending instruments. We are discussing a very different question—the effect of such regulations upon non-regulated parties. In our view, the Bank Board's regulations speak to the regulated parties (federally chartered savings and loans) and go only to whether the institutions may enter into contracts containing particular clauses. The regulations do not, and can not, act to impair the rights of a party over whom the Bank Board has no regulatory authority. The Bank Board may properly determine, by regulation, whether regulated lenders may enter into contracts containing due-on-sale clauses; it may not determine the legal effect of such a clause upon a third party. This issue was not present in *Conference of Fed. S. & L. Ass'ns* v. *Stein,* 604 F.2d 1256 (9th Cir. 1979) *aff'd mem.* 445 U.S. 921 (1980). In *Stein,* the court emphasized that its holding dealt only with procedural rules, not the substantive rights of borrowers. 604 F.2d at 1260.

[23] In fact, Congress is presently considering a bill (S. 1703) which would expressly preempt state due-on-sale restrictions. If such action is to be taken at all, it should be taken by a body whose actions have the constitutional legitimacy inherent in accountability to the electorate. By contrast, the Bank Board considers the savings and loans to be its only "constituency". For example, the "task force" whose conclusions the Bank Board has improperly asked this Court to accept as gospel [Bank Board Brief, fn. 15 at p. 21] consists solely of savings and loan executives; no other views were represented. See also T. Marvell, *The Federal Home Loan Bank Board* 217-218 (1969). ["[The Bank Board] has stayed . . . free from the influence of Congress, the White House, and, especially, the public. However . . . it is under strong pressure from the industry it regulates and frequently buckles under this pressure."]; *Id.* at 229 ["The contacts of the [Bank Board] outside the government are limited to the savings and loan industry . . . ."].

This interpretation of HOLA comports with the general rule respecting the authority of federal regulatory bodies. It is generally held that a Congressional grant of authority to a regulatory body does not include the power to impair the rights of a third party in his dealings with a regulated party. The leading case is *Regents of University System of Georgia v. Carroll,* 338 U.S. 586 (1950). In that case, the F.C.C. had renewed a broadcast license to a licensee with the proviso that "no further effect" be given to an operating agreement between the licensee and a third party. The third party promptly brought action on the contract in state court; the state court rejected the licensee's defense based on the F.C.C. order and entered judgment for the third party. This Court affirmed, and unanimously held that the federal regulatory body had no authority to abrogate the state law rights of a nonlicensee. It stated that the F.C.C. "cannot directly affect the applicant's responsibilities to a third party dealing with the applicant" [338 U.S. at 600] and went on to hold:

> "Under the present statute, the Commission could make a choice only within the scope of its licensing power, *i.e.,* to grant or deny the license on the basis of the situation of the applicant. It could insist that the applicant change its situation before it granted a license, but it could not act as a bankruptcy court to change that situation for the applicant. * * * * We do not read the Communications Act to give authority to the Commission to determine the validity of contracts between licensees and others." 338 U.S. at 602.

Similarly, in *Nader v. Allegheny Airlines, Inc.,* 426 U.S. 290 (1976), an airline passenger who was "bumped" in compliance with C.A.B. regulations brought a fraud action against the airline. This Court held that the action could be maintained, and stated that the C.A.B. had no power to immunize the airline from liability. 426 U.S. at 300-301. And in *Gulf, Mobile & Ohio R. Co. v. Illinois Central R. Co.,* 225 F.2d 816 (5th Cir. 1955), the Court of Appeals concluded the following, in reliance on *Regents v. Carroll:*

> "[T]he licensing and regulatory powers granted to administrative bodies by Congress do not authorize the abrogation of, or have the effect of abrogating, private contracts merely because such contract may, to a considerable degree, affect the results sought to be accomplished by the act of regulation or licensing." 225 F.2d at 822.

The foregoing cases represent a sound general rule. They recognize that Congress creates regulatory bodies to control a specified class of persons, and that the authority of such regulatory bodies ordinarily does not extend to controlling the rights of those over whom they have not been given regulatory authority.

There are strong reasons why that result should apply with especial force here. As discussed above, there is no indication whatever that Congress intended that the general language of §5(a) would be construed to mean that the Bank Board could abrogate the state-created rights of borrowers.[24] Given the extremely limited function which federally chartered savings and loans were intended to serve in the Congressional scheme (see pp. 6-10, *supra*), such a result is hardly mandated by the purposes of Congress.

Moreover, the present proceeding is one in which a federal regulatory body is claiming a Congressional mandate to abrogate state laws concerning real estate — the most local of subjects, and traditionally the exclusive domain of state law.[25] To accept Appellants' position here is to accept the proposition that Congress gave a federal regulatory body *carte blanche* to

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[24] It is more than a little ironic that the Bank Board should view HOLA—an act expressly intended for the benefit of borrowers—as a mandate for depriving borrowers of the protections which they have been guaranteed under state law.

[25] The law of real estate "has always been deemed a matter of local sovereignty." *Humble Oil & Refining Co. v. Sun Oil Co.*, 191 F.2d 705, 713 (5th Cir. 1951). This Court has noted that "[e]ven when federal general law was in its heyday, an exception was carved out for local laws of real property." *United States v. Little Lake Misere Land Co., Inc.*, 412 U.S. 580, 591 (1973).

repeal all local laws of real estate—affecting the rights of millions of borrowers—whenever they would affect the financial interests of federally chartered (but privately owned) business entities, which themselves derive their rights *vis a vis* borrowers solely from state law.[26] This massive intrusion of a federal regulatory body into an area which has historically been the exclusive province of state law would be a drastic redefinition of the respective spheres of operation of the "separate, yet coordinate, federal and state sovereignties." *Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware,* 414 U.S. 117, 127 (1973). This Court has stated that "unless Congress conveys its purpose clearly, it will not be deemed to have significantly changed the federal-state balance." *United States v. Bass,* 404 U.S. 336, 349 (1971).[27] In the present instance, no portion of the legislative history of HOLA supports the conclusion that Congress intended to delegate the right to effect such a significant disruption of the federal-state balance.[28] In adopting HOLA, Congress never even discussed the possibility that the Bank Board could take such action and the general language of HOLA, standing alone, cannot constitute the "unambiguous congressional mandate" which this Court requires before state law will be displaced in such an instance. *Florida Lime & Avocado Growers, Inc.* v. *Paul,* 373 U.S. 132, 146-147 (1963).

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[26] Every right which Appellants seek to enforce in this proceeding is a right *based solely upon state law.* The very existence and effect of Appellants' deeds of trust depends upon their recognition under state law; the priority of those liens is determined by state law; the right to enforce those liens is a right granted and controlled by state law; and the method of enforcement is specified solely by state law.

[27] To similar effect, see *Head v. New Mexico Board of Examiners,* 374 U.S. 424, 431-432 (1963) ["In the absence of positive evidence of legislative intent to the contrary, we cannot believe Congress has ousted the States from an area of such fundamentally local concern."]; *San Diego Building Trades Council v. Garmon,* 359 U.S. 236, 244 (1959) [Where the matter touches interests "deeply rooted in local feeling and responsibility" a court will not find preemption "in the absence of compelling congressional direction. . . ."].

[28] We are, of course, disregarding those secret Congressional "purposes" for HOLA which Appellants, the Bank Board and the U.S. League purport to have divined, but no member of Congress saw fit to mention. However, acceptance of these supposed "purposes" would only indicate Congressional dissatisfaction with state regulatory practices; it hardly indicates an intent to revise "pernicious" state real property law.

Indeed, it seems virtually inconceivable that Congress would have intended that the Bank Board could deprive unregulated parties of state-created rights when the rights in question arose from state laws concerning real property. Real property law consists of a "tightly-knit complex of doctrines" [Note, "Federal Common Law," 82 *Harvard L. Rev.* 1512, 1518 (1969)], which are carefully integrated to balance competing interests. If the Bank Board's present position is correct, then the Bank Board may simply authorize federally chartered savings and loans to take advantage of all state real property doctrines which benefit lenders, while disregarding the safeguards upon which those benefits are conditioned.[29] It seems inconceivable that Congress could have intended this bank regulatory body to blunder about in an area where it has no expertise, when the effects would be so profoundly disruptive of a carefully integrated system of local laws. If Congress were to have contemplated that the Bank Board could deprive third parties of state-created rights, the area of real estate law would be the last area in which Congress would have intended to give the Bank Board such authority.

If the Bank Board's authority were construed in the manner suggested by Appellants, the Bank Board would be doing far more than providing for "the organization, incorporation, examination, operation and regulation" of federally chartered savings and loan associations; it would be regulating borrowers in the guise of regulating savings and

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[29] For example, California grants lenders a speedy and efficient method of private foreclosure which completely eliminates the necessity of filing suit to foreclose a consensual lien upon real property. California Civil Code §§2924 *et seq.* This procedure is tightly controlled with safeguards to prevent abuse, including a statutory cure period [California Civil Code §2924c] and a prohibition upon deficiency judgments if the lender elects nonjudicial foreclosure. California Code of Civil Procedure §580d. If Appellants' view is accepted, the Bank Board could, by regulation, permit federally chartered savings and loan associations to take advantage of California's statutory procedure for nonjudicial foreclosure, while disregarding the safeguards (the cure periods and restrictions upon deficiencies) upon which the use of that procedure is conditioned.

loans. If Appellants' contention is accepted, then three bank regulators in Washington would have the power, by the stroke of a pen, to eliminate every borrower protection which the courts and state legislatures have ever developed. It is inherently incredible to suggest that Congress intended, by the vague language of 12 U.S.C. § 1464(a), to empower three political appointees to rewrite the law of real estate and thereby abrogate the state-created rights of literally millions of borrowers. We can find no portion of HOLA which gave the Bank Board such enormous power over persons it has not been authorized to regulate.

II.

THE DEEDS OF TRUST THEMSELVES MAY NOT PERMIT AUTOMATIC FORECLOSURE UPON SALE.

It is important to recognize that the determination of the specific issue before this Court may not determine the rights of the parties. If the decision of the Court of Appeal is affirmed, then the rights of the parties are clear; the due-on-sale clauses may not be enforced under the circumstances here present. However, if the determination of the Court of Appeal is reversed, these cases must be remanded for interpretation of the deeds of trust involved.

A determination that the Bank Board's regulation superseded California real property law would not, of itself, mean that a federally chartered savings and loan association may institute foreclosure proceedings every time real property subject to its mortgage is transferred. Rather, the regulation specifies that the right of the lender to accelerate the loan "shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by that contract." 12 C.F.R. §545.8-3(f). If the Bank Board's regulation is deemed to be preemptive, the "terms of the loan contract"—not the Bank Board's regulation—would determine the rights of the parties.

In the present case, however, the deeds of trust have yet to be definitively construed. The matter was decided without trial, and the basis for decision by the Court of Appeal made it unnecessary to decide whether the deeds of trust permitted foreclosure.[30] Accordingly, if preemption is found, the case must be remanded to determine whether, under applicable principles of contract interpretation, the "terms of the loan contract" permitted foreclosure.[31]

It is true that the three deeds of trust involved in this proceeding all contained due-on-sale clauses which imposed no express limitation upon the lender's discretion to accelerate the maturity of the loan upon sale. However, it is by no means

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[30] The Court of Appeal concluded that the lender's foreclosure upon transfer would, under the circumstances of the case, constitute an unreasonable restraint upon alienation. Accordingly, it was irrelevant whether the contract itself permitted foreclosure because foreclosure could not properly be permitted in any event.

[31] We assume that "applicable principles of contract interpretation" would be determined under state law. Otherwise the "choice of law" provision in the FNMA/FHLMC Uniform Instruments would be essentially meaningless. Appellants seem to suggest that deeds of trust on the Uniform Instruments should be construed as a matter of federal law in order to attain uniformity. Appellants' Brief, fn. 13 at p. 33. We suggest that Appellants have not given sufficient thought to this matter. If federal law governed the interpretation of the Uniform Instruments, then every mortgage foreclosure action under the Uniform Instruments would present a federal question; it would be within the jurisdiction of the federal district courts under 28 U.S.C. § 1331 and, if brought in state court, could be removed to federal court under 28 U.S.C. § 1441(a). See *State of Illinois v. City of Milwaukee*, 406 U.S. 91, 99-100 (1972); *De Simone v. Warwick Fed. S. & L. Ass'n*, 482 F. Supp. 1190, 1194-1195 (D.R.I. 1980). Even this would not guarantee uniformity of interpretation because (1) each Uniform Instrument contains non-uniform covenants tailored to the law of the particular state, (2) if preemption is found here, the application of the Uniform Instruments will vary according to the identity of the lender (see fn. 2 at p. 4 herein), and (3) with 62 possible sources of interpretation (50 state courts of last resort and 12 federal circuits) uniformity could only be achieved if this Court decided a lengthy series of mortgage foreclosure cases.

frivolous to suggest that appropriate interpretation of the deeds of trust would result in an implied limitation upon this seemingly unbridled discretion. This conclusion is based upon two related doctrines of contract interpretation which are clearly applicable to the deeds of trust in question: (1) the interpretive rules applicable to contracts of adhesion; and (2) the covenant of good faith and fair dealing implied in all contracts. These well established principles afford a substantial basis for concluding that, as a matter of contract interpretation, a mortgagee's discretion to exercise a due-on-sale clause may be limited by considerations of reasonableness and fairness.

It can hardly be doubted that the deeds of trust were contracts of adhesion; they were non-negotiable forms offered on a "take it or leave it" basis, imposed by a party with superior bargaining power upon a party with lesser (or nonexistent) bargaining power.[32] Because of these peculiar characteristics, the nineteenth century notions of mutual assent are largely inapplicable to contracts of adhesion:

> "The consent in these adhesion contracts is a fiction. The party handed a form usually has no time to read it, would not understand it if he took the time, would not be able to find anyone with authority to change it if he wished to, and very likely would not be able to make the transaction if he insisted upon a change from the standard form." J. Sweet, "Liquidated Damages in California," 60 *California L. Rev.* 84, 85 (1972) (footnote omitted).

This Court has recognized that contracts of adhesion are subject to different principles of interpretation than would apply to negotiated commercial contracts[33] and it has been suggested that the construction of a contract of adhesion "is *sui*

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[32] Indeed, the FHLMC requires that only mortgages on the standard form are eligible for purchase. *FHLMC Sellers' Guide-Conventional Mortgages*, § 1.407. The FHLMC thus exerts substantial economic pressure on lenders to make certain that they will not negotiate the terms of the mortgages with borrowers (even in the unlikely event they were inclined to do so).

[33] Compare *Fuentes v. Shevin*, 407 U.S. 67, 95 (1972) with *D.H. Overmyer Co., Inc. of Ohio v. Frick Company*, 405 U.S. 174, 188 (1972).

generis, and the rules of a legal system devised to govern the formation of ordinary contracts between man and man cannot be mechanically applied to it." 7 *Williston on Contracts*, §900, p. 30 (3d Ed. (Jaeger) 1963). Because there is no true mutual assent to a contract of adhesion, such contracts are construed in accordance with the reasonable expectations of the weaker party, notwithstanding non-negotiable "boiler plate" provisions at variance with those expectations. K. Llewellyn, *The Common Law Tradition: Deciding Appeals* 370-371 (1960), F. Kessler, "Contracts of Adhesion—Some Thoughts About Freedom of Contract," 43 *Columbia L. Rev.* 629, 637 (1943); R. Keeton, "Insurance Law Rights at Variance With Policy Provisions," 83 *Harvard L. Rev.* 961, 967 (1970); E. Patterson, "The Interpretation and Construction of Contracts," 64 *Columbia L. Rev.* 833, 858 (1964); *Restatement (Second) Contracts, Tentative Drafts Nos. 1-7*, §237, Comments e and f (1973). At a minimum, contractual provisions which materially affect the weaker party's rights must be conspicuous and clear.[34] And where a contractual provision is unreasonable or unfair, it may be disregarded entirely.[35]

An additional principle applicable here is the implied covenant of good faith and fair dealing present in every contract. This obligation requires that "neither party shall do anything which will have the effect of destroying or injuring the right of the other party to receive the fruits of the contract. . . ." 5 *Williston on Contracts* §670 at p. 159 (3d Ed. (Jaeger) 1961). This implied obligation "emphasizes faithfulness to an agreed common purpose and consistency with the justified expectations of the other party. . . ." *Restatement (Second)*

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[34] See *Fuentes v. Shevin, supra*, 407 U.S. at 95; *Gray v. Zurich Ins. Co.*, 65 Cal. 2d 263, 270-272, 54 Cal. Rptr. 104, 419 P.2d 168 (1966); *Restatement (Second) Contracts, Tentative Drafts Nos. 1-7*, §237, Illustration 7; American Law Institute, *Uniform Laws Annotated: Uniform Commercial Code* §§ 1-201(10), 2-316(2); 1 *Corbin on Contracts* §33, p. 131 (1963).

[35] See American Law Institute, *Uniform Laws Annotated: Uniform Commercial Code* § 2-302; *Restatement (Second) Contracts, Tentative Drafts Nos. 1-7*, §234; California Civil Code §1670.5; *Henningsen v. Bloomfield Motors, Inc.*, 32 N.J. 358, 161 A.2d 69, 95 (1960).

Contracts, Tentative Drafts No. 1-7, §231, Comment a (1973). A significant aspect of this obligation in the context of the present case is that it has often been used to limit (by standards of good faith or reasonableness) the ability of a party to exercise a contractual right which, on its face, appears completely discretionary.[36]

The foregoing principles provide a substantial basis for concluding that the apparently unfettered discretion of the lender to accelerate upon sale is, at a minimum, restricted by considerations of reasonableness, fairness and the reasonable expectations of the borrower. The principal economic terms of the loan contract (what Professor Llewellyn refers to as the "dickered terms")[37] provided for a long-term mortgage loan in a specified amount at a specified interest rate. Yet, buried in the bowels of the fine print is a provision which changed those terms materially; the loan was not a long-term loan at all (the lender now tells us), but became due whenever the borrower sold his home. This clause — which materially affects the rights of the parties — is far from conspicuous and there is no indication that any of the mortgagees in the cases before the

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[36] See, *e.g.*, *Schoolcraft v. Ross*, 81 Cal. App. 3d 75, 79-81, 146 Cal. Rptr. 57 (1978); *Foster Enterprises, Inc. v. Germania Fed. S. & L. Ass'n*, 97 Ill. App. 3d 22, 421 N. E. 2d 1375, 1381 (1981); *Fortune v. National Cash Register Co.*, 373 Mass. 96, 364 N.E. 2d 1251, 1256-1258 (1977); *Loengard v. Metal & Thermit Corp.*, 204 F. Supp. 74, 76-77 (S.D.N.Y. 1962); *Restatement (Second) Contracts, Tentative Drafts Nos. 1-7*, § 231, Illustration 9; 3A *Corbin on Contracts* § 647 (1960).

[37] K. Llewellyn, *The Common Law Tradition: Deciding Appeals* 370-371 (1960). Professor Llewellyn suggests that a contract of adhesion consists of the few "dickered" (*i.e.*, negotiated) terms. The remainder of the document—the non-negotiated "boiler plate"—is only a part of the contract to the extent that "(1) it does not alter or impair the fair meaning of the dickered terms when read alone, and (2) that its terms are neither in the particular nor in the net manifestly unreasonable or unfair." *Id.* at 371.

Court even knew of its existence at the time the contract was entered into.[38] Moreover, the due-on-sale provision is in the security instrument (the deed of trust) although it is now asserted that the clause has nothing whatever to do with the lender's security, but is a critical economic term of the contract. See Bank Board Brief, pp. 20-21. If this is so, inclusion of the provision in the deed of trust (where it is surrounded by provisions intended to protect the lender's security) is decidedly misleading, since a lay borrower would expect that a deed of trust would only contain provisions to protect the lender's security.

Under the circumstances present here, it cannot be said that the "terms of the loan contract" unambiguously permit foreclosure upon sale of the property secured by the deed of trust; the lender's apparently unlimited discretion to foreclose is almost certainly limited by considerations of fairness and reasonableness. Accordingly, if preemption is found, these cases should be remanded for a definitive construction of the deeds of trust.

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[38] In the two non-FNMA/FHLMC deeds of trust before the Court, the provision is contained in paragraph 4(k)(3), in the midst of language which would be completely incomprehensible to a lay borrower (and most lawyers). Jt. App. 24-25, 103-104. In the FNMA/FHLMC form, the provision is contained in paragraph 17 (out of 26 paragraphs), and the language is only slightly more comprehensible. Jt. App. 68. In neither case is the provision highlighted by a conspicuous print style or color, nor does the paragraph title give the borrower any clue that the paragraph contains a provision permitting the lender to accelerate the loan upon transfer. In fact, the paragraph heading of the FNMA/FHLMC form ("Transfer of the Property; Assumption") is affirmatively misleading in suggesting that a purchaser may assume the loan upon a sale of the property.

CONCLUSION

The principal issue in this case is the extent to which the federal bureaucracy may, through aggressive revision of its "mandate", expand its powers far beyond any boundaries ever contemplated by Congress. Congress created the federal savings and loan system for a very limited purpose, and designated the Bank Board as a bank regulatory agency to administer that system. The Bank Board has now claimed that Congress has authorized it to exert control over millions of borrowers and to rewrite state real property laws to suit the financial convenience of the federal savings and loans. There is no reason to believe that Congress gave any such authority to the Bank Board. If action with such enormous implications for our federal system is to be taken, it must be taken by Congress.

The decision of the Court of Appeal should be affirmed.

Dated: March 25, 1982

Respectfully submitted,

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Amicus Brief

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In the Supreme Court

OF THE

United States

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,
Appellants,

vs.

REGINALD D. DE LA CUESTA, et al.,
Appellees.

On Appeal from the California Court of Appeal for the Fourth Appellate District

BRIEF OF THE CALIFORNIA ASSOCIATION OF REALTORS, STANLEY E. PANKO AND GEORGE L. SINCLAIR, AS AMICI CURIAE IN SUPPORT OF APPELLEES

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QUESTIONS PRESENTED

1. Should the decision below be affirmed as correctly concluding that federally-chartered savings and loan associations, in connection with their mortgage loans made in California to California borrowers and secured by California real property, must observe California law, uniformly applied to state-chartered, federally-chartered, and noninstitutional mortgage lenders, which restricts the use of "due-on-sale" clauses to accelerate mortgage loans to circumstances where such acceleration does not create unreasonable restraints on alienation as proscribed by state statute?

2. Did the court below correctly conclude that a choice of law clause in a printed mortgage loan contract providing for the application of the "law of the jurisdiction" constitutes a relinquishment by the lender responsible for the adhesive language of any claim of federal preemption; in interpreting this clause, did the Court of Appeal properly apply principles of contract interpretation embodied in California statutes?

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No. 81-750

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BRIEF OF THE CALIFORNIA ASSOCIATION OF REALTORS, STANLEY E. PANKO AND GEORGE L. SINCLAIR, AS AMICI CURIAE IN SUPPORT OF APPELLEES

I

IDENTITY AND INTERESTS OF THE AMICI

This brief is filed in support of Appellees with the written consent of the parties in accordance with Rule 36.2. The Amici Curiae joining in this brief are the California Association of Realtors, Stanley E. Panko, and George L. Sinclair.

The California Association of Realtors (CAR) is a trade association of California real estate professionals. Its roughly 130,000 members are engaged in real estate sales and financing as brokers, sales agents, and mortgage bankers. CAR's members share a common and urgent interest in preserving the free alienability of real property in California and in the application of uniform contract and property law to all California mortgages.

Stanley E. Panko and George L. Sinclair are purchasers of California real property encumbered by a mortgage from a federally-chartered savings and loan association. Panko and Sinclair are appellees in a related case currently pending before this Court on a Motion To Affirm Or Dismiss, *Pan American Savings and Loan Association, et al. v. Panko and Sinclair,* No. 81-922. The interests of Panko and Sinclair will be directly affected by the Court's disposition of the issues in this case.

II

PRELIMINARY STATEMENT

California sanctions the inclusion and enforcement of "due-on-sale" clauses in real property mortgages in order to fully protect the mortgagee against any risk to or impairment of security attendant upon alienation of the encumbered property. *Wellenkamp v. Bank of America,* 21 Cal.3d 943 (1978); see, Hetland, *Real Property and Real Property Security: The Well-Being of the Law,* 59 Cal.L. Rev. 151 (1965). However, California courts have held that unreasonable restraints on alienation, violating California

Civil Code § 711, are created when a due-on-sale clause is invoked *automatically*, that is, where sale is used as a pretext for acceleration of a mortgage loan for reasons totally unrelated to protection of the lender's security interest. *Id.*[1]

California's prohibition of automatic due-on-sale acceleration is not in any sense an attempt to regulate or set policy for federally-chartered savings and loan associations or any other category of institutional lenders. The restriction applies to *all* mortgages encumbering California real property, whether made by banks, thrifts, brokers, or private individuals, and is based on the basic police power of the state to construe and limit contractual terms so as to reconcile them with important public policies. *Dawn Investment Co. v. Superior Court*, 30 Cal.3d 695 (1982).

The crux of the present dispute centers on Appellants' invocation of the preemption doctrine in an effort to gain a special exemption, not enjoyed by any other mortgage lender, from this one aspect of California's law of real

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[1]*Automatic* acceleration on sale and acceleration to protect the lender from an increased risk of default after sale (*Defensive* acceleration) have very different consequences in terms of restraints on alienation. Defensive acceleration creates relatively minimal restraints. The borrower must find a purchaser who presents no increased risk to the lender if he wants to avoid acceleration upon sale, but he is not faced with the absolute choice between forfeiting a valuable loan or forgoing sale altogether. Automatic acceleration creates just such a Hobson's choice: The borrower cannot avoid forfeiture, no matter how assiduously he avoids compromising the lender's security. And the very conditions which motivate a lender to accelerate—i.e., a large "spread" between the contractual rate of interest and higher prevailing rates—makes the borrower's forfeiture all the more severe. Under these conditions, it is not surprising that many borrowers simply decline to sell. When this occurs, it serves no interest of the lender, compromises important public policies, and injures the borrower, the prospective purchasers, and real estate markets in general.

property and contracts. The signal failure of Appellants' preemption claims is not only that they have failed to establish any recognized basis for preemption, but that they have failed to suggest any reason why they should or logically can be allowed to use the doctrine of preemption to selectively reject one aspect of California land law while enjoying the benefit of the rest.

III

SUMMARY OF ARGUMENT

The text and legislative history of the Home Owners Loan Act of 1933 ("HOLA") contain no hint that Congress intended or expected that the newly created federal savings and loan associations would be exempt from generally applicable state law; in fact, the history and purposes of HOLA support the opposite conclusion. Application of state law of contracts, property, and mortgages to the federal associations in connection with their tenure and exercise of security interests in local real property does not frustrate or interfere with any congressional purpose, policy, or goal. There is, in short, no basis for a finding of preemption through congressional occupation of the field.

Appellants have consequently relied very heavily on the regulations of the Federal Home Loan Bank Board ("Bank Board") and on a claim of preemption on the basis of a supposed "conflict" between these regulations and California law. Yet, under the accepted test for the existence of a preemptive conflict—impossibility of dual compliance with both state and federal dictates—no conflict can be said to exist between California law and present or past Bank Board regulations.

As a last resort, Appellants have relied on expressions by the Bank Board of a desire to insulate the federal associations from state restrictions on automatic due-on-sale acceleration. However, under well-established preemption analysis, these expressions of preemptive desire

by an administrative agency do not oust state law in the absence of an immediate and irreconcilable conflict and in the face of strong evidence that Congress fully intended state law to control the contractual dealings and property rights of the federal associations.

As a totally independent basis for its decision, the Court of Appeal correctly construed the adhesive language of the choice of law clause against Fidelity Federal and interpreted such clause as constituting a covenant to be bound by California law. This result is correct under both state and general common law principles of contract interpretation.

IV

ARGUMENT

A. The Court of Appeal Correctly Applied Accepted Preemption Analysis in Reaching the Conclusion That Appellants Are Not Exempt From California's Restrictions on Mortgage Terms Which Restrain Alienation of Local Real Property

This Court has always recognized that protecting the residual powers and sovereignty of the states (U.S. Const., Art. X) is fully as important to the American scheme of federalism as is the supremacy of the Federal Government in those areas in which it has constitutionally exerted its authority. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 132 (1978); *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977). As a result, both major theories of preemption —"congressional occupation of the field" and "conflict"— have been applied with extreme caution and with a presumption in favor of the continuing validity of state law. *Id.; Chicago & N.W. Tr. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311 (1981); *Alessi v. Raybestos-Manhattan, Inc.*, 451 U.S. 504, 522 (1981); *Carbon Hill Health Care, Inc. v. Beasley*, 528 F.Supp. 421, 423 (1981). The reluctance to oust state law is particularly pronounced in two circumstances, both of which obtain in the present case.

The first circumstance concerns state law in areas, such as contracts, property, and mortgages, which historically have been the province of the states and which remain a central focus of traditional state sovereignty and police power:

> "[B]efore preemption shall be deemed to have occurred, there must be either a clear manifestation of such congressional intent or a conflicting inconsistency between state and federal regulations. *Florida Lime & Avocado Growers, Inc. v. Paul,* 373 U.S. 132, 142, 83 S.Ct. 1210, 10 L.Ed.2d 248 (1963); *California v. Zook,* 336 U.S. 725, 733, 69 S.Ct. 841, 93 L.Ed. 1005 (1949). This is particularly true where the field of regulation is one that has been traditionally occupied by the states. *Jones v. Rath Packing Co.,* 430 U.S. 519, 525, 97 S.Ct. 1305, 51 L.Ed.2d 604 (1977)."
> *Katherine Gibbs School (Inc.) v. F.T.C.,* 612 F.2d 658, 667 (2d Cir. 1979).

Accord: *United States v. Kimbell Foods, Inc.,* 440 U.S. 715 (1979); *Butner v. United States,* 440 U.S. 48 (1979); *United States v. Yazell,* 382 U.S. 341 (1966).

Judicial reluctance to find federal preemption of generally-applicable state law in areas historically controlled by the states is based not only on deference to traditional state sovereignty but also on the recognition that state general civil law is the end-product of centuries of common law evolution and of a delicate balancing of conflicting public and private interests in light of local customs and conditions. The law of contracts, real property, and mortgages are classic examples of such laboriously evolved and delicately balanced areas of state law. *Aronson v. Quick Point Pencil Co.,* 440 U.S. 257 (1979); *United States v. Little Lake Misere Land Co., Inc.,* 412 U.S. 580 (1973); *State Land Board v. Corvallis Sand & Gravel Co.,* 429 U.S. 363 (1977). Piecemeal federal preemption (particularly by federal regulatory agencies seeking special treatment for their regulatees) can only serve to balkanize state law into

a multitude of special rules applicable to special interests, thereby disrupting the balance of state general civil law and the policies which it has evolved to effectuate. See, e.g., *Butner v. United States*, 440 U.S. 48 (1979) (*intra*state uniformity necessary to reduce uncertainty and forum shopping). *United States v. Fox*, 94 U.S. 315 (1877); Hart, *The Relations Between State and Federal Law*, 54 Colum. L.Rev. 489, 553 (1954).

The second area of particularly strong deference to state law is where the state law in question serves a consumer protection function. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963); *Morseburg v. Balyon*, 621 F.2d 972 (9th Cir. 1980) (citing Note, *The Preemption Doctrine: Shifting Perspectives On Federalism And The Burger Court*, 75 Colum.L.Rev. 623 (1975)). In such areas, the courts have consistently declined to find preemption of state law providing more stringent consumer protections than those provided by federal law. *Id.*

In light of these authorities, the Court of Appeal subjected Appellants' preemption claims to a rigorous scrutiny and found them unsupported under any established preemption test or theory. A review of the pertinent statutes and regulations will make clear that the Court of Appeal reached the appropriate result.

1. **The Text and Legislative History of HOLA Establish That Congress Has Not Preempted State Law Concerning the Property Rights and Contractual Dealings of the Federal Associations and Has Not Delegated Any Similar Preemptive Power to the Bank Board**

   a. **The Text of HOLA Supports the Conclusion That General State Law Controls the Contractual and Property Rights of the Federal Associations**

HOLA contains no preemptive language, and in the roughly 50 years since HOLA was enacted, no court has

found that HOLA expressly preempts state law concerning the enforcement and interpretation of contracts between the federal associations and their borrowers.

Nevertheless, judging by the frequency with which Appellants and their amici quote from or paraphrase Section 5(a) of HOLA (12 U.S.C. § 1464(a)), Appellants apparently contend that the language of this section, defining the responsibilities and authority of the Bank Board, constitutes an expression of congressional preemptive intent.

Appellants and their supporting amici claim to find particular support for their position in Section 5(a)'s grant of authority to the Bank Board to "regulate" the federal associations and, in so doing, to give primary consideration to the "best practices" of local thrift and home financing institutions. Purely as a textual matter, and disregarding the legislative history which contradicts Appellants' preemption claims, neither these passages nor any other aspect of Section 5(a) provides support for Appellants' position.

The language of Section 5(a) plainly empowers the Bank Board to *regulate* the federal associations, i.e., to occupy a sphere of authority similar to that occupied by state regulatory bodies charged with regulating local thrifts. But does this delegation of regulatory authority authorize the Bank Board to oust the basic body of state contract and property law which provides the context within which the federals necessarily operate? To use a metaphor: The Bank Board was given plenary power over the fish, but was it given power to change the rules of the sea within which the fish must swim?[2]

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[2]The distinction between "regulation" and the general application of contract and property laws is perfectly illustrated by the private, individual lender, who is fully subject to California's restrictions on due-on-sale acceleration. As a private individual, such a lender is not subject to regulation by any body such as the Bank Board or the California Savings and Loan Commissioner. Nonetheless, when this individual makes a mortgage loan, he still must

Appellants and their amici argue that the Bank Board was given such power. But they do not reconcile this ambitious claim of authority with the historical fact that neither Congress nor the Bank Board has ever attempted to set up a separate body of law uniquely applicable to the property rights, security interests and contracts of the federal associations.

Appellants' stratagem is obvious and it undercuts their entire preemption argument. Where they deem state law to be unfavorable, they claim that state law "regulates" them and is therefore preempted by HOLA. But when they find state law congenial, they observe and employ it without making the slightest mention of the fact that it too must necessarily be preempted if Congress has really occupied the field involving the contractual dealings of the federal associations with their borrowers.[2]

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observe some body of general law concerning security instruments, title to property, remedies upon default, and so forth. There is no source of such general law *except* state law. *City of Milwaukee v. Illinois*, 451 U.S. 304 (1981).

[2]It is well-established that *all* state law within a field occupied by congressional action is automatically and categorically preempted even if harmonious with federal law. *Campbell v. Hussey*, 368 U.S. 297 (1961); *Textile Workers v. Lincoln Mills*, 353 U.S. 448, 456-57. Thus, if Congress has really occupied a field encompassing all law directly or indirectly affecting the federal associations, then *all* state law would have been preempted and the federal associations would have been operating in a legal vacuum for the past 50 years.

Yet, the reported cases are replete with examples of federal associations observing and taking advantage of state laws. In fact, in a recent California case involving the validity of late charges, a federally-chartered lender litigated all the way to the California Supreme Court on the basis of state law without ever so much as suggesting that federal law had preempted applicable state law. *Garrett v. Coast & Southern Fed. Sav. & Loan Assn.*, 9 Cal.3d 731 (1973). For a sample of the numerous other cases in which federal associations have asserted California law as both a defense and as a basis for their own affirmative claims without even hinting at fed-

Since there exists not a scintilla of evidence that Congress intended to exempt the federal associations from all generally-applicable state property law (a privilege which the Federal Government does not arrogate even to itself in its contractual dealings with private citizens), a line must exist at which federal regulatory power ends and generally-applicable state law begins. Unless the federal associations are to be given an unconscionable advantage over their competitors and borrowers by being allowed to choose which state laws they will obey, this line must be defined and adhered to regardless of the vicissitudes of the economy.[4]

b. The Cases Interpreting HOLA Have Not Found Preemption of General State Contract and Property Law.

Appellants and their amici repeatedly cite the same few trial court and appellate preemption decisions which were resolved with careless references to broad "cradle to grave

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eral preemption, see, *Glendale Fed. Sav. & Loan Assn. v. Marina View Heights Dev. Co.*, 66 Cal.App.3d 101 (1977) (involving numerous points of contract, tort, and mortgage law); *Wilson v. San Francisco Fed. Sav. & Loan Assn.*, 62 Cal.App.3d 1 (1976) (impound accounts); *Lazzareschi Inv. Co. v. San Francisco Fed. Sav. & Loan*, 22 Cal.App.3d 303 (1971) (prepayment penalties); *In re Wilton-Maxfield Management Co.*, 117 F.2d 913 (9th Cir. 1941) (antideficiency statutes, particularly Cal.CodeCiv.Proc. § 580b).

[4]A similar attempt to obtain special exemption from general state law was recently rejected by this Court in a case involving the National Bank Act. The Court stated:

> "[P]etitioner completely fails to identify any national or local interests which its reading of the [National Bank Act and, in particular, Sections 52 and 57 thereof] would serve. That reading would give national banks engaged in the business of making loans secured by mortgages on real estate a privilege unavailable to competing lenders. No reason has been advanced for assuming that Congress intended such disparate treatment."

Third National Bank v. Impac Limited, Inc., 432 U.S. 312, 323 (1977).

preemption" dicta and which failed even to consider the absence of any law but state law which can be looked to to determine and implement the contractual and property rights of the federal associations. See *People v. Coast Federal Savings & Loan Assn.*, 98 F.Supp. 311 (S.D.Cal. 1951); *Meyers v. Beverly Hills Federal Savings & Loan Assn.*, 499 F.2d 1145 (9th Cir. 1974).[5] However, the decision below and most other recent decisions define the appropriate sphere of preemption as the "internal" affairs of the federal associations. These decisions *explicitly* reject the "cradle to grave" rubic as inaccurate and singularly unhelpful. See *Panko v. Pan American Fed. Sav. & Loan Assn.*, 19 Cal.App.3d 916, 922 (1981); *Holiday Acres No. 3 v. Midwest Federal, etc.*, 308 N.W.2d 471 (Minn.S.Ct. 1981); *Gulf Fed. S.&L., etc. v. Federal Home Loan Bank Board*, 651 F.2d 259, 266 (5th Cir. 1981).

Gulf Federal S.&L., etc. v. Federal Home Loan Bank Board, supra, is perhaps the most revealing of the recent cases which draw the "internal"/"external" distinction because *Gulf Federal*, unlike the present case, involved a conflict *between* a federal association and the Bank Board concerning the scope of the Board's regulatory power. In resoundingly rejecting the Bank Board's customary claim of "cradle to grave" preemption, the Fifth Circuit stated:

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[5]Appellants and amici would also rely upon the more recent decision in *Conference of Federal Savings & Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1979), aff'd mem., 445 U.S. 921 (1980). *Conference* is substantially different from the *Coast Federal* or *Meyers* decisions because it involved the power of a California governmental agency to directly regulate and supervise the *internal* practices and policies of the federal associations with regard to "redlining", a civil rights issue with peculiarly federal implications under the fourteenth amendment and the federal civil rights acts. The holding in *Conference* was painstakingly limited by the Ninth Circuit to apply only to preemption of the power of a state *executive agency* to directly interfere with the *procedural* aspects of the federal associations' daily operations, and the holding is entirely consistent with the argument advanced in this brief and with the reasoning and holding of the decision below. *Id.*, at 1260.

> "These cases [citations omitted], and others like them cited by the Board, stand only for the proposition that federal law governs the *internal management* of federal savings and loan institutions.
>
> "Gulf Federal's conduct in this case, however, has nothing to do with the internal management of the association. The disputed loan provision is part of a contract between the association and its borrowers. Such contracts do not implicate the sound management of the savings and loan or the insurance liability of the government, nor do they require a uniform federal rule to assure sound and well-managed savings and loan institutions. See, *DeSimone v. Warwick Federal Savings and Loan Ass'n.*, 482 F.Supp. 1190, 1194 (D.R.I. 1980). Federal law does not establish whether Gulf Federal breached its agreements. *Gulf Federal's loan agreements were made under Louisiana law, and Louisiana law must determine the rights of the parties to the contract.*"
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> *Gulf Federal S.&L., etc. v. Federal Home Loan Bank Board*, 651 F.2d 259, 266 (5th Cir. 1981) (emphasis in first paragraph in original; emphasis in second paragraph added).

In sum, the text of HOLA lends no support whatever to Appellants' preemption claims and considerable support to the proposition that Congress intended the Bank Board to regulate only the internal affairs of the federal associations.[6]

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[6]A number of other textual factors affirmatively demonstrate that Congress did not intend to preempt state law of contract and mortgages. Insufficient space exists to discuss them all; however, one deserves particular mention.

Section 5(f) of HOLA, 12 U.S.C. § 1464(f), requires all of the federal associations to become members of the Federal Home Loan Bank system. The principal benefit of membership in the

c. The Circumstances Surrounding HOLA's Enactment and Subsequent Congressional Actions Support the Non-Preemption Conclusion

The federal associations were created at the height of the Great Depression to enter intrastate mortgage money markets and to make available additional sources of long-term home loans, particularly in the roughly one-half of the counties nationwide then without local thrift or savings and loan institutions.[7] They are purely private institutions, are not federal instrumentalities, and do not perform any uniquely federal functions.[8]

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system is the ability to borrow against the security of "home mortgages". See 12 U.S.C. § 1430. The term "home mortgage" had been specifically defined, a year earlier, in the Federal Home Loan Bank Act as "such classes of *first liens as are commonly given to secure advances on real estate by institutions authorized under this chapter to become members, under the laws of the State in which the real estate is located*, together with the credit instruments, if any, secured thereby". 12 U.S.C. § 1422(6) (emphasis added). If Congress intended that the lending instruments of federally-chartered savings and loan associations were not to be governed by state law, the failure of Congress to revise this definition is simply inexplicable. Indeed, if the lending instruments of federally-chartered savings and loan associations are not governed by state law, the Federal Home Loan Banks have, for 48 years, been illegally making advances to their federally-chartered members on the security of instruments which are not "home mortgages" as defined in the statute.

[7] HOLA § 5(a), 48 Stat. 128, 132 (1933), 12 U.S.C. § 1464(a); cf. Report of the House Committee on Banking and Currency (HR Rept. No. 55) 73rd Cong. 1st Sess., p. 2 (April 25, 1933); Hearings on HOLA HR 49080, HR Committee on Banking and Currency, pp. 14-15 (April 21, 1933).

[8] *Gibson v. First Federal Savings and Loan Association*, 347 F.Supp. 560, 563 (E.D.Mich. 1972); *Midwest Fed. Sav. & Loan Ass'n v. Com. of Rev.*, 259 N.W.2d 596, 598 (Minn. 1977); cf. *United States v. Orleans*, 425 U.S. 807 (1976); *Perez v. United States*, 594 F.2d 280 (1st Cir. 1979); *Housing Authority, etc. v. State of Wash.*, 629 F.2d 1307 (9th Cir. 1980); United States League of Savings Associations, *Savings and Loan Fact Book*, 1979, p. 46.

At the time HOLA was enacted, the Federal Government had been chartering national banks for 70 years. National Bank Act of 1863. In fact, the system created by the National Bank Act served as a paradigm for HOLA, as demonstrated by the parallels between the 12 regional Federal Home Loan Banks and the 12 regional Federal Reserve Banks.

It is instructive then to observe that at the time of HOLA's enactment there had been no question for at least 63 years that the contracts of the national banks were controlled by state law:

> "[National banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the Nation. *All of their contracts are governed and construed by state laws. Their acquisition and transfer of property, their right to collect their debts, and their liability to be sued for debt, are all based on state law.* It is only when the state law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional."
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> *First National Bank v. Commonwealth of Kentucky*, 76 U.S. (9 Wall.) 353, 362 (1870) (emphasis added).

Accord: *Third National Bank v. Impac Limited, Inc.*, 432 U.S. 312 (1977).

If exemption from fairly-applied state contract and property law had been necessary or even helpful to the purpose which Congress had in mind when it enacted HOLA, it is inconceivable in view of Congress' experience with the national banks that it would not have expressly stated its preemptive intent.

Congress did not express a preemptive intent because preemption was completely irrelevant to the legislative purpose of HOLA, i.e., the creation of additional outlets for mortgage money in areas where no existing home-loan

institutions were available. This narrow and highly specific purpose was expressed consistently in debates and reports on the bills which would become HOLA.[9]

Appellants and their amici have failed to explain why the creation of a supplemental contingent of lenders for areas not already served required the abrogation of (or the delegation to the Bank Board of power to abrogate) traditional state contract and property law which had always applied to local lenders and national banks alike. The mystery deepens when it is recalled that neither Congress nor the Bank Board has ever made any attempt to create a substitute body of law.

Apparently recognizing that the actual legislative history of HOLA provides infertile soil for their preemption arguments, Appellants and their amici have created a legislative history out of whole cloth. They repeatedly assert that HOLA was designed to rectify a problem caused by "prevailing", "pernicious" state practices.[10] Yet they cite not a shred of legislative history in support of their effort to graft onto HOLA a completely fictional legislative history and congressional purpose.[11]

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[9]See, e.g., 77 Cong. Rec. 2480 (April 27, 1933), and 77 Cong. Rec. 2486 (April 27, 1933).

[10]See, particularly, Appellants' Brief on the Merits, p. 12.

[11]In fact, the historical record directly contradicts Appellants' claims. A particularly revealing reaffirmation of Congress' nonpreemptive intent occurred in connection with the enactment of the Depository Institutions Deregulation and Monetary Control Act of 1980, 94 Stat. 161. The Senate Report concerning the Act stated:

> "In exempting mortgage loans from state usury limitations, the Committee intends to exempt only those limitations that are included in the annual percentage rate. The Committee does *not intend to exempt limitations on prepayment charges, attorney fees, late charges or similar limitations designed to protect borrowers.*"
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> Senate Report No. 96-368 at p. 19 (October 15, 1979), reprinted in 1980 *U.S. Code Cong. & Admin. News* 236, 255 (emphasis added).

Even if one accepted, *arguendo*, Appellants' fictional account of "pernicious state practices" as a basis for HOLA, this fact would not provide logical or historical support for preemption of state contract and property law.

If Congress did intend HOLA to rectify certain state practices, it intended to do so through the fair, free, and equal competition of federal associations (observing the best *policies* and *practices*) with local thrift institutions. HOLA § 5(a), 12 U.S.C. § 1464(a). This point is crucial. It is submitted that it would have been virtually unthinkable for Congress in 1933 to correct lending abuses at the state level by creating a privileged class of private mortgage lenders cloaked with total immunity from state laws respecting their contractual dealings with state residents and affecting property located within the state. Such a massive and overbroad assault on federalism is as implausible now as it was in 1933. Yet it is precisely this legislative intent which must be inferred in order to support a finding of preemption.

The unstated premise of Appellants' preemption arguments is that the primary purpose of HOLA is to benefit the federal associations themselves. This stands history on its head. The associations are a means of realizing the purposes of HOLA, not the recipients of its benefits. This point was reiterated in 1975 by then-Chairman Bomar of the Bank Board in testimony before the House of Representatives:

> "[W]e do not attempt to make the case for the benefit of savings and loans. There is no justification to do anything to benefit savings and loans per se. They are a tool to help savers and borrowers. . . ."
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> Hearings before the House Subcomittee on Financial Institutions, Supervision, Regulation, and Insurance, 94th Congress, 1st Session, p. 249 (April 8, 9, 10, 1975).

2. California's Restrictions on Restraints on Alienation and Automatic Due-On-Sale Acceleration Do Not Obstruct Any Congressional Purpose

Originally created to fill geographic gaps, the federal associations today compete directly with state-chartered institutions in identical markets for real estate secured mortgages. The proliferation of both state and federally-chartered institutions has left few, if any, areas of the country without at least several institutions with each type of charter.[12]

State and federally-chartered institutions typically use the same "uniform" mortgage instruments, sell mortgage paper on the same secondary markets, and freely exchange their federal charters for state charters (or vice versa) in an effort to seek the most favorable regulatory climate. With minimal exceptions, both types of associations operate strictly within the boundaries of a single state.[13]

In short, the federal associations no longer serve their original and unique function of providing outlets for mortgage money in previously unserved areas. They are, in essence, nothing more than a group of private lenders which at any particular moment happen to hold a federal rather than a state charter and which observe federal regulations respecting their organization, operations, and record keeping. The "federals" are not the standard bearers for any congressional policies and purposes. In light of their current role, there is simply no basis in law or logic for inferring any congressional purpose for the federal associations other than that they remain in existence, be well-managed, follow rational, enlightened business policies, and be allowed to compete with other mortgage lenders on a fair and equal basis.

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[12]Neither Appellants nor their amici suggest that the federal associations serve any population not also served by their state-chartered competitors.

[13]See, 12 C.F.R. 545.8-6 (1980) and proposed 556.5(a)(3).

Appellants argue that California's due-on-sale restrictions interfere with a federal purpose by "threatening the financial stability" of the associations. Yet the evidence—even that offered by Appellants and their amici—is all to the contrary. California-chartered savings and loans are among the soundest in the country, despite the fact that they have been subject to California's prohibition on automatic due-on-sale acceleration since very early in the recent period of high interest rates. The three largest savings and loans in the nation operate under California law, eight of the fifteen largest savings and loans in the nation are California state-chartered institutions,[14] and California-chartered thrifts have consistently been the "strong half" in recent mergers.

Perhaps the most reliable indicator of the falsity of Appellants' apocalyptic claims is what the savings and loans do and say.

In this regard, consider *Panko v. Pan American Fed. Sav. & Loan Assn.*, 119 Cal.App.3d 916 (1981) (appeal pending in this Court in No. 81-922). In that case, it is undisputed that shortly after obtaining a finding of preemption in the trial court on the due-on-sale issue, the lender (by no means one of the larger or stronger federal associations) *voluntarily converted to state-chartered status*. This action is totally inexplicable if exemption from California law is a crucial or even a significant factor in the vitality of the thrifts.

Even the highly-biased Due-On-Sale "Task Force"[15] report propounded by the Bank Board, as amicus, in support of Appellants' position concludes that the earning levels of California-chartered and federally-chartered associations "do not differ appreciably" and that any "losses" result-

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[14]Moody's *Bank and Financial Manual* (1980), p. a8.

[15]The "Task Force" was made up *exclusively* of representatives of the savings and loan industry. See Task Force Report, p. ii.

ing from due-on-sale restrictions are fully offset by regulatory adjustments which *both* state and federal associations now enjoy. Task Force Report, pp. 16-17.[16]

It may be true that it would be "advantageous" to the federal associations to disregard California's due-on-sale restrictions. It would probably also be advantageous to the "federals" to be able to obtain deficiency judgments prohibited by California law,[17] to obtain "strict foreclosure" of mortgages upon default without the necessity for competitive sale,[18] to disregard the reinstatement and redemption rights of their defaulting borrowers,[19] or to claim priority for their mortgage liens regardless of the sequence of recordation.[20]

However, such a result would make a mockery of the doctrine of preemption and of the tenth amendment, and would leave traditional state real property law riddled with inconsistencies. This situation would be contrary to the overwhelming body of authority holding that matters of contract and real property, far from being inherently

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[16]This last factor is particularly significant in view of this Court's repeated holding that even where a state-federal conflict exists, it will not give rise to preemption if there exists a means to reconcile the conflict. See, *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142 (1963); *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 132 (1978); *Kelly v. Washington*, 302 U.S. 1, 10 (1937); *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 45 (1966); *Huron Cement Co. v. Detroit*, 362 U.S. 440, 446 (1960); *Hisquierdo v. Hisquierdo*, 439 U.S. 572, 581 (1979).

[17]Cal.Code Civ.Proc. §§ 580a, 580b, 580d, and 726; See Hetland, *California Real Estate Secured Transactions* (Cal.Cont.Ed.Bar 1970), p. 233, *et seq.*

[18]In violation of Cal.Civ.Code §§ 2889, 2924, 2963, and Cal.Code Civ.Proc. § 726; See Hetland, *Secured Real Estate Transactions* (Cal.Cont.Ed.Bar 1974), pp. 125-26.

[19]As guaranteed by Cal.Civ.Code §§ 2903, 2904, 2924c; See Hetland, *Secured Real Estate Transactions, supra*, at pp. 123-24.

[20]Contrary to California's recording act, Civ.Code § 1214; See Hetland, *California Real Estate Secured Transactions, supra*, pp. 204-5.

national, are matters of uniquely local concern.[21] "It is a strange argument that permits one to pick and choose what portion of the law binds him." *First Nat. Bank v. Walker Bank*, 385 U.S. 252, 261 (1966).

Appellants and their amici have also placed great reliance on an alleged need for national uniformity in the interpretation of form mortgage instruments used in different states under different bodies of substantive property and contract law.

However, as two California Courts of Appeal (including the court below) and the Minnesota Supreme Court have noted, the Bank Board's due-on-sale regulations do nothing more than designate the due-on-sale clause as a *permissive* contractual term, an approach totally inconsistent with the claim that nationally uniform due-on-sale clauses are essential. *Panko v. Pan American Fed. Sav. & Loan Assn.*, 119 Cal.App.3d 916, 924 (1981); *de la Cuesta v. Fidelity Fed. Sav. & Loan Assn.*, 121 Cal.App.3d 328, 342 (1981); *Holiday Acres No. 3 v. Midwest Federal, etc.*, 308 N.W.2d 471 (Minn. 1981).

Moreover, preemption will not encourage national uniformity in secondary markets. State-chartered lenders participate just as fully in these national markets as do the federal thrifts and thereby promote any federal interest in the operation of these markets.[22] A finding of preemption would replace interstate diversity with intrastate diversity; that is, identical "uniform" mortgage instruments executed within a single state would be construed

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[21] *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979); *State Land Board v. Corvallis Sand & Gravel Co.*, 429 U.S. 363 (1977); *United States v. Little Lake Misere Land Co.*, 412 U.S. 580 (1973); *Sunderland v. United States*, 266 U.S. 226 (1924); *United States v. Fox*, 94 U.S. 315 (1877).

[22] The secondary markets are by no means exclusively federal or national. Major secondary markets exist totally independent of any congressional action on a regional basis and within the larger states.

differently depending on whether they were originated by a state-chartered or a federally-chartered lender.

Preemption of selective aspects of California property law insofar as applied to the mortgage instruments of the federal associations would therefore destroy the *intra-state* uniformity vital to maintain the policies and balance developed by state law under unique local conditions and relating to local real property; it would permit the federal associations to fashion their own body of law by accepting "favorable" state rules while rejecting the concomitant restrictions; and it would do all this without achieving any national uniformity in secondary markets which deal in the mortgage instruments of state as well as federally-chartered lenders. Such a result will advance no federal purpose or interest. See, *Butner v. United States*, 440 U.S. 48 (1979); *Johnson v. First Fed. Sav. & Loan Ass'n of Detroit*, 418 F.Supp. 1106, 1109 (E.D.Mich. 1976).

3. California Law Restricting Automatic Due-On-Sale Acceleration Does Not Conflict With Any Regulation of the Bank Board

To serve as a basis for preemption, state/federal conflicts must be direct, immediate, and irreconcilable. *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 130 (1977); *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35, 45 (1966); *Kelly v. Washington*, 302 U.S. 1, 10 (1937). No such conflict is created by the application of California law respecting restraints on alienation to due-on-sale clauses in the loan instruments of federal associations.

a. By Designating the Contract as the Controlling Authority, the Bank Board Has Avoided Preemption of State Law

In designating *the contract* as controlling in its 1976 regulations, 12 CFR § 545.6-11(f), (g)[23], the Bank Board did not provide that the exercise of the due-on-sale clause

[23]Now in slightly modified form at 12 C.F.R. § 545.8-3. The original classification will be used throughout this brief.

would be governed by federal law. The Board thereby implicitly recognized that no general federal law of property and contracts exists which is designed to govern the interpretation and enforcement of mortgages in general, or the exercise of due-on-sale rights in particular.

In determining that the contract would "govern", the drafters of the 1976 regulations certainly were aware that all contracts necessarily require construction to effectuate the intent of the parties and to protect public policy. The drafters were also aware, or were chargeable with the knowledge, that state law controls the validity and interpretation of contracts affecting rights in local land.[24] Moreover, the drafters knew very well that in applying state law to the enforcement of contracts the courts necessarily take into consideration important state policy considerations.

Even if, despite the foregoing, the Board can reasonably be said to have intended preemption by designating the contract as controlling, this would constitute an ineffectual attempt by the Bank Board to delegate preemptive power to private business entities, a clear violation of the tenth amendment and an act radically beyond the delegation of authority contained in Section 5(a) of HOLA.

Thus, in providing that "the contract" governs the federal associations' due-on-sale rights under local real property mortgages, the Board has done nothing to diminish the states' pre-1976 authority and has left the door wide open for state law limitations on the exercise of due-on-sale rights. *Joseph E. Seagram & Sons, Inc. v. Hostetter*, 384 U.S. 35 (1966); *Huron Cement Co. v. Detroit*, 362 U.S. 440 (1960).

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[24] *Aronson v. Quick Point Pencil Co.*, 440 U.S. 257 (1979); *Pickering Lumber Corp. v. Whiteside*, 54 Cal.App.2d 200, 210 (1942), *cert. denied*, 318 U.S. 763 (" . . any contract affecting title to the real property situated in California is to be construed according to the laws of California"); *Gruen Watch Co. v. Artists Alliance*, 191 F.2d 700, 703 (9th Cir. 1951); *Riess v. Murchison*, 329 F.2d 635, 643 (9th Cir. 1964).

b. Purely Permissive Federal Regulations Cannot Preempt

A second and independent reason why no conflict can be said to exist is that the 1976 regulations are purely permissive. The decision to exercise due-on-sale acceleration is that of the federal association and not that of the Bank Board. It is entirely possible for a federal association to comply with California's limited restrictions on the exercise of due-on-sale rights without violating federal law. There is no conflict giving rise to preemption.

A number of decisions have expressly rejected claims of federal preemption, where stricter state consumer or debtor protection laws prohibit what more lenient federal laws would permit. Thus, in *McClellan v. Chipman*, 164 U.S. 347, 356-57 (1896), this Court held that a state law precluding banks from taking real property as security for a pre-existing debt was valid as applied to a national bank, even though the National Bank Act expressly authorized such a taking. Similarly, this Court noted no "impossibility of dual compliance" and found no preemption where state law set stricter produce standards than did the federal government. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963).[25]

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[25]Numerous other decisions firmly support the view that the states may reasonably restrict what federal regulations merely permit. See, *Huron Cement Co. v. Detroit*, 362 U.S. 440, 446-48 (1960) (federally licensed vessel subject to nondiscriminatory state laws); *William Inglis, etc. v. ITT Continental Baking Co.*, 668 F.2d 1014, 1049 (9th Cir. 1981) (state restrictions on predatory pricing); *Kargman v. Sullivan*, 552 F.2d 2, 6, 13 (1st Cir. 1977), *reh. denied* 558 F.2d 612 (1977) *and later app.* 582 F.2d 131 (1978) (federal permission to raise rents does not justify violation of rent control law where federal action permissive, not mandatory); *Hughes v. Trans World Airlines, Inc.*, 336 A.2d 572, 578-79 (Del. Supr. 1975), *cert. denied* 423 U.S. 841 (1975), *and on remand* 374 A.2d 5 (Del. Ch. 1977); *State ex rel. Andrus v. Click*, 554 P.2d 969 (Idaho 1976); *Marshall v. Consumers Power Co.*, 237 N.W.2d 266, 280-81 (Mich. 1976).

It is entirely possible for federal associations to fully comply with HOLA and all Bank Board regulations without automatically invoking due-on-sale clauses. Thus, California and federal laws are not in any constitutionally cognizable conflict, and there exists no reason to cut a broad swath through California laws protecting consumers and favoring the free alienability of land contained within its borders for the benefit of a group of private lenders which do business within the state and take full advantage of state law.

c. A Mere Expression of Preemptive Intent by the Bank Board Cannot Give Rise to Preemption in the Absence of a Direct Conflict Between State and Federal Law

The Court of Appeal correctly noted that only Congress has the power to preempt state law by fiat and that federal regulatory agencies can preempt state laws, particularly those within the sphere of traditional police powers, only by enacting duly authorized regulations which irreconcilably conflict with state law. *de la Cuesta v. Fidelity Fed. Sav. & Loan Assn.*, 121 Cal.App.3d 328, 340 (1981).

Appellants and their amici cite several cases which they claim stand for the proposition that a federal regulatory body may preempt state law even in the absence of congressional occupation of the field and without demonstrating an irreconcilable state/federal conflict merely by expressing a preemptive intent. However, a review of the cases cited[26] reveals that all of these cases involved direct, irreconcilable conflicts between state and federal law.

There is no place in the American scheme of federalism for preemption by regulatory fiat. Where a regulatory

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[26]*Free v. Bland*, 369 U.S. 663 (1962); *United States v. Shimer*, 367 U.S. 374 (1961); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *Bethlehem Co. v. State Board*, 330 U.S. 767 (1947); and *City of Burbank v. Lockheed Air Terminal*, 411 U.S. 624 (1973).

agency enacts specific regulations which conflict with a state law, the agency has, presumably, carefully considered the policies and conflicting interests in response to which the preempted state law has evolved. But where, as here, an agency is claimed to have attempted to preempt general state law without developing a carefully balanced body of regulations with which to replace it, the result will inevitably be confusion, distortion of state law, and state/federal antagonism. Since preemption may occur only pursuant to a congressional intent and purpose, it is only where a regulatory agency, acting pursuant to congressional mandate, has enacted a specific regulation which *unavoidably and irreconcilably* conflicts with state law that a preemptive state/federal conflict will be said to exist. *Malone v. White Motor Corp.*, 435 U.S. 497 (1978); *Florida Lime & Avocado Growers, Inc. v. Paul, supra;* see, also, *Chrysler Corp. v. Brown*, 441 U.S. 281 (1979); Hirsh, *Toward a New View of Federal Preemption*, 1972 U.Ill.L.Forum 515, 551. Neither Appellants nor their amici have identified such a conflict.

d. The Bank Board's 1976 Regulations Have No Application to Mortgage Loans in Place Prior to the Effective Date of the Regulations

Appellants and some of their amici argue that the 1976 regulations retroactively altered the rights of borrowers under pre-existing mortgages. This position is insupportable.

The "first rule of construction" is that legislation is presumed to be strictly prospective unless the "unequivocal and inflexible import" of the statutory language and the "manifest intent" of the legislature requires retrospective operation. *Greene v. United States*, 376 U.S. 149, 160 (1964); *Claridge Apartments Co. v. Comm.*, 323 U.S. 141, 164 (1944); *Union Pac. Ry Co. v. Laramie Stockyards*, 231 U.S. 190, 199 (1913). This fundamental principle applies with equal force and identical effect to the interpreta-

tion of administrative regulations. *City Federal Savings and Loan Assn. v. Crowley*, 393 F.Supp. 644 (E.D.Wis. 1975).

The Bank Board's 1976 regulations contain no language whatsoever mandating a retrospective application and, in fact, expressly state a prospective "effective date."[27] 12 C.F.R. § 545.6-11(f)(g). Thus, by virtue of the "first rule" discussed above, these regulations must be given a prospective-only interpretation. *Bailey v. First Federal S. & L. Assn. of Ottawa*, 467 F.Supp. 1139, 1141 (C.D.Ill. 1979); see O'Connell, *The Due-On-Sale Clause in Florida; A Potential Battleground for Borrowers and Lenders*, XXXI, U.Fla.L.Rev. 933, 954 (1979).

It is urged by one of Appellants' amici that an intent to enact retroactive regulations may be deduced from the fact that the Bank Board, roughly a year before promulgation of its 1976 regulations, had interpreted earlier regulations, 12 C.F.R. § 545.6-11 (1948), as "authorizing" due-on-sale clauses and preempting state law to the contrary.[28] However, such an *interpretation* is far from the "unequivocal

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[27]It is likely that the Bank Board was well aware of the serious constitutional difficulties which would be created by a regulatory attempt to retroactively alter the vested property and contract rights of third parties. See, e.g., *Home Bldg. & L. Assn. v. Blaisdell*, 290 U.S. 398 (1934).

[28]The 1948 regulations made no mention of due-on-sale clauses or any other specific mortgage term. They merely directed the federal associations to provide for their "full protection" in their mortgage instruments. The plain meaning of this "full protection" language is that the federal associations were directed to obtain adequate security and all rights and protections available to them under state law. The Bank Board's interpretation of these 1948 regulations stretches canons of statutory interpretation beyond all reason. Thus, the Board would construe the hopelessly vague and general "full protection" language as preempting all state law protecting borrowers but as apparently leaving unaffected state law favoring lenders. Such an interpretation is nothing short of absurd.

and inflexible" expression of *intent* required by *Greene v. United States, supra.* (In fact, if the Board truly believed that it had already preempted state law, there would have been no need to make the 1976 regulations retroactive or, for that matter, to enact them at all. A statute (or regulation) is not construed as being retroactive merely because it refers to or draws upon antecedent facts. *United States v. Jacobs,* 306 U.S. 363 (1939); see, *Sitzman v. City Board of Education,* 61 Cal.2d 88, 89 (1964).

B. State Real Property Law Is Peculiarly Local; The Court Of Appeal Correctly Held That Use Of A Choice Of Law Clause Adopting "The Law Of The Jurisdiction" In A Form Mortgage Designed Specifically For Use In California Constituted An Agreement By The Parties That The Mortgage Would Be Construed and Enforced In Accordance With The Law Of California, The State Which Is The Situs Of The Mortgage, The Parties, And The Affected Property.

Since admission to the federal union, California has exercised plenary authority over real property located within the state. Cal.Civ.Code § 155. Thus, the ordinary and popular interpretation of any real property contract or instrument executed within California, pertaining exclusively to California land and selecting the "law of the jurisdiction" as the applicable general law, would be that the term "jurisdiction" means the State of California.

This natural interpretation is reinforced by the fact that such a clause would be nonsensical if "jurisdiction" were taken to mean the United States. This is the case because the United States does not claim authority over intrastate land which it does not own and because, as discussed, there simply is no federal law of real estate or mortgages. *State Land Board v. Corvallis Sand & Gravel Co.,* 429 U.S. 363 (1977) (under federal system property ownership governed by state law, not general federal law); *City of Milwaukee*

v. Illinois, 451 U.S. 304 (1981); *United States v. Fox*, 94 U.S. 315, 320-21 (1877).[29]

Appellants and amici argue that the phrase "law of the jurisdiction" really means "the law of California, which has totally been preempted, and therefore federal law". See, e.g., Appellants' Brief on the Merits, p. 31 *et seq.* There are numerous flaws in this argument.

First, it must be recalled that the issue in this case is not a theoretical consideration of federalism, but instead the *interpretation* of adhesive contractual language imposed by an institutional lender on individual borrowers.

Second, Appellants' argument would mean that identical contractual language would have diametrically opposite

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[29]Indeed, land law and the law of real estate mortgages are the quintessential subjects of state law:

> "It is true, too, that '[t]he great body of law in this country which controls acquisition, transmission, and transfer of property, and defines the rights of its owners in relation to the state or to private parties, is found in the statutes and decisions of the state.' Even when federal general law was in its heyday, an exception was carved out for local laws of real property. Indeed, before *Erie R. Co. v. Tompkins, supra*, this Court's opinions left open the possibility that even 'the United States, while protected by the Constitution from discriminatory state action, and perhaps certain other special forms of state control, was nevertheless governed generally in its ordinary proprietary relations by state law.' Hart, The Relations Between State and Federal Law, 54 Col.L.Rev. 489, 553 (1954)."
>
> *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 591-92 (1973) (citations omitted).

meanings when used by a federal association or by its state-chartered competitor across the street."[29]

Third, if one accepts Appellants' occupation of the field arguments, the "choice of law" clause would be surplusage when used by a federal association because there can be no conflict of law under a uniform, preemptive body of federal law. Of course, no such body of law exists, but this "technicality" has escaped mention in Appellants' arguments.

Fourth, even if a preemptive federal common law of contracts did apply, there is no reason to believe that such law would be inconsistent with California's restrictions on automatic due-on-sale acceleration based on California Civil Code § 711. Where federal law for some reason controls in an area typically the subject of federal law, federal law will commonly "adopt" state law.

> "In the absence of some overriding federal interest in uniformity, the applicable state law generally provides the rule of the decision."
>
> *United States v. Conrad Pub. Co.*, 589 F.2d 949, 953 (1978); citing and relying on *United States v. Yazell*, 382 U.S. 341 (1966); *United States v. Marshall*, 431 F. Supp. 888-891 (N.D.Ill. 1977).

Accord: *United States v. Kimbell Foods, Inc.*, 440 U.S. 715 (1979); *United States v. Hargrove*, 494 F.Supp. 22, 23 (D.N.M. 1979); cf. Mishkin, *The Variousness of "Federal Law": Competence and Discretion In The Choice of National and State Rules for Decision*, 105 U.Pa.L.Rev. 797 (1957).

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[29]The fact that identical "uniform" deed of trust forms are used by lenders with both types of charters speaks volumes about the indistinguishable functions and character of "state" and "federal" savings and loan institutions. It is also highly instructive that the "uniform" mortgage instruments such as those disseminated by the Federal Home Loan Mortgage Corporation are expressly designed for use in a particular state under local property and mortgage law.

Indeed, where there exists a rational body of state law, it is "inappropriate" for courts to develop a specialized body of (federal common) law applicable to the activities of a particular federally-related entity or instrumentality. *United States v. Conrad Publishing Company*, 589 F.2d 949, 953 (1978) (Small Business Administration).[21]

The foregoing makes clear that, in interpreting the choice of law clause as a waiver, the Court of Appeal was correctly applying at least five principles of contract interpretation firmly embedded in California law and the general common law of contracts. The Court gave the words of the clause their ordinary and usual meaning. Cal. Civ.Code § 1644. It interpreted any ambiguity against the party who caused that ambiguity. Cal.Civ.Code § 1654. It gave the clause a uniform interpretation, whether used by state or federally-chartered lenders. Cal.Civ.Code § 1635. And it avoided an interpretation which would have made a choice of law clause a contradiction in terms and a total irrelevancy. Cal.Civ.Code §§ 1641 and 1643.

V

CONCLUSION

Appellants and their amici would have this Court make deep inroads into an area of the law—the contract affecting rights in local land—which is literally at the heart of the traditional police powers of the state in order to gain a commercial advantage for purely private institutions operating exclusively within the boundaries of a single state. Moreover, Appellants ask this Court to find preemption despite a total lack of Congressional preemptive intent and despite a total failure to demonstrate the existence of any federal purpose which would require or recommend such an intrusion upon state sovereignty.

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[21]Cf. *Brown v. Avemco Inv. Corp.*, 603 F.2d 1367 (9th Cir. 1979) (required showing of impaired security prior to foreclosure under U.C.C., citing *Wellenkamp*).

However, the days are long past when it was assumed *a priori* that federal control is better just because it is federal. In an era when previously unknown economic conditions have placed borrowers and lenders alike on the defensive, it is all the more urgent that this Court reaffirm the concept of federalism which has given the United States 200 years of diversity and the freedom to address social and economic problems in a manner consistent with local conditions.

For these reasons, the California Association of Realtors, Stanley E. Panko, and George L. Sinclair respectfully urge this Court to affirm the decision below.

Dated: March, 1982

Respectfully submitted,

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Amicus Brief

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Supreme Court, U.S.
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Supreme Court of the United States

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL.,
Appellants,

-v-

REGINALD D. DE LA CUESTA, ET AL.,
Appellees.

On Appeal from the California Court of Appeal, Fourth Appellate District

AMICUS CURIAE BRIEF OF THE CONSUMER'S COMMITTEE TO PROTECT MORTGAGE RIGHTS

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INTEREST OF AMICUS

The Consumer's Committe to Protect Mortgage Rights is a statewide organization of consumers and real estate professionals in Michigan supporting enactment of laws promoting the free transferability of homes by homeowners. The committee is circulating petitions to initiate legislation in Michigan restricting exercise of due on sale clauses. The committee is vitally interested in the outcome of this case, which affects the rights of thousands of Michigan mortgagors who have obtained mortgages from federal savings and loan associations. The committee submits this brief in support of appellees' position to preserve state law protections for homeowners which limit exercise of due on sale clauses to cases where the lender's security is impaired.

SUMMARY OF ARGUMENT

Appellants argue that the Home Owners Loan Act of 1933, 12 USC 1461-1470 ("HOLA") and regulations of the Federal Home Loan Bank Board ("Board") preempt California law which limits the exercise of due on sale clauses in deeds of trust to cases where the lender's security is impaired.

This Court's cases hold that federal preemption of state law can occur in three ways: where there is an actual conflict between federal and state law, where there is a dominant federal interest or pervasive scheme of federal regulation, or where state law is expressly preempted by Congress. None of these conditions are satisfied here and there is, therefore, no preemption.

There is no conflict between federal and California law. The federal regulation merely permits, but does not require, use of due on sale clauses. California law does not prohibit enforce-

ment of due on sale clauses. It establishes a test of reasonableness for their enforcement. Under these circumstances, both federal and state law can be reconciled, there is no impossibility of compliance with both, and, hence, no preemption by conflict.

There is no dominant federal interest or pervasive regulatory scheme which requires displacement of California law. HOLA permits some areas of federal s&l activity to be governed by state law. It expresses no policy about due on sale practices. The Board's own permissive regulation belies a need for national uniformity. Other federal statutes and federal agencies have policies inconsistent with the Board's due on sale policy. Since there is no clear comprehensive and pervasive federal scheme of due on sale regulation, California law is not preempted.

Neither is there any express preemption. Neither HOLA nor the Board's regulation expressly preempts state law. The Board's policy statements, which do not have the effect of law since they were not promulgated as substantive regulations, are not entitled to controlling weight, in view of the lack of evidence of Congressional intent to preempt state law and the lack of uniform federal policy in this area.

For deeds of trust executed before June 8, 1976, the effective date of the Board's due on sale regulation, there can be no preemption. There is no statutory or regulatory basis for preemption before 1976.

ARGUMENT

General Principles

This Court has stated that federal preemption of state law can occur in three ways:

1. an actual conflict between federal and state law;

2. a dominant federal interest or pervasive scheme of federal regulation;

3. a Congressional expression of unequivocal intent to preempt state law.

E.g., **Ray** v **Atlantic Richfield Co**, 435 US 151, 157-158 (1978); **Jones** v **Rath Packing Co**, 430 US 519, 525 (1977); **City of Burbank** v **Lockheed Air Terminal, Inc**, 411 US 624, 633 (1973); **Rice** v **Santa Fe Elevator Corp**, 331 US 218, 230 (1947). The issue "in each case is what the purpose of Congress was." **Rice**, id.; **Malone** v **White Motor Co**, 435 US 497, 504 (1978). This Court has developed several important canons of interpretation.

First, there is always a presumption against preemption.

> Pre-emption of state law by federal statute or regulation is not favored "in the absence of persuasive reasons -- either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained."

Chicago & N W Transp Co v **Kalo Brick & Tile Co**, 450 US 311, 317 (1981); **DeCanas** v **Bica**, 424 US 351, 356 (1976); **Florida Lime & Avocado Growers, Inc** v **Paul**, 373 US 132, 142 (1963). The goal should be to avoid invalidating state law. **Merrill Lynch, Pierce, Fenner & Smith, Inc** v **Ware**, 414 US 117 (1973); **Silver** v **New York Stock Exchange**, 373 US 341, 357 (1963). Congress can always change the result by future legislation. An erroneous determination of preemption, however, leaves the state powerless to remove the effect of the Court's decision. **City of Burbank**, 411 US at 643 (Rehnquist, J., concurring); **Penn Dairies, Inc** v **Milk Control Commission**, 318 US 261, 275 (1943).

Second, this presumption is particularly strong in an

area "traditionally occupied by the states." **Jones,** 430 US at 525. In such a case, "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the **clear and manifest purpose** of Congress." **Ray,** 435 US at 157; **Jones,** 430 US at 525; **City of Burbank,** 411 US at 633; **Florida Lime,** 373 US at 146; **Rice,** 331 US at 230. (Emphasis added.) To find a "complete ouster of state power," **DeCanas,** 424 US at 357, there must be "an unambiguous Congressional mandate to that effect." **Florida Lime,** 373 US at 147.

Real property law is traditionally the domain of state law. **Butner** v **United States,** 440 US 48, 55-56 (1979) ("Property interests are created and defined by state law . . . . The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests . . . The rule we adopt . . . looks to state law to find the security interest of the mortgagee . . . ."); **Oregon** v **Corvallis Sand & Gravel Co,** 429 US 363, 378 (1977), and **Davies Warehouse Co** v **Bowles,** 321 US 144, 155 (1944) ("The great body of law in this country which controls acquisition, transmission, and transfer of property, and defines the rights of its owners in relation to the state or to private parties, is found in the statutes and decisions of the state."); **Hoopeston Canning Co** v **Cullen,** 318 US 313, 318 (1942) (state law is the "source of law for . . . . mortgages, and for many other legal principles respecting property interests."); **United States** v **Fox,** 94 US 315, 320 (1877). **See also Aronson** v **Quick Point Pencil Co,** 440 US 257, 262 (1979) ("Commercial agreements traditionally are the domain of state law.").

Third, preemption may be limited to some aspects of an area of legislation. **Kelly** v **Washington,** 302 US 1, 10 (1937) ("There is no constitutional rule which compels Congress to occupy the whole field. Congress may circumscribe its regulation and occupy only a limited field. When it does so, state regulation outside that limited field and otherwise admissible is not forbidden or displaced.").

With these general principles in mind, we now explore Congressional intent in HOLA.

HOLA Legislative Scheme

"The search for Congressional intent begins with the language of the statute." **Steadman** v **SEC**, 450 US 91, 97 (1981); **Andrus** v **Allard**, 444 US 51, 56 (1979). HOLA directed the Board to regulate federal s&ls "to provide for the organization, incorporation, examination, operation and regulation" of them, and to charter them, "giving primary consideration to the best practices" of state s&ls. 12 USC 1464 (a)(1).

HOLA expressly regulated the internal operations of federal s&ls. It made clear certain operations are exclusively governed by federal law. See, for example, 12 USC 1464(b) (raising capital, borrowing authority, credit cards); 12 USC 1464(c) (investment authority); 12 USC 1464(d) (regulation of unsafe and unsound practices and violations of law); 12 USC 1464 (1) and (n) (trust powers).

HOLA contains some express preemptions. See, for example, 12 USC 1464(a)(1) (branching for certain federal s&ls); 12 USC 1464(h) (states can't tax federal s&ls higher than state s&ls). Another statute expressly preempts state usury laws for federal s&ls. 12 USC 1730g(a).

On the other hand, HOLA has many express provisions that defer specifically to state law. See, for example, 12 USC 1464(b)(3) (authorization to borrow from state mortgage finance agencies as permitted by state law); 12 USC 1464(c)(4)(A) (lending to a business development credit corporation as permitted under state law); 12 USC 1464(c)(4)(B) (investments in certain service corporations in a federal savings and loan's home state); 12 USC 1464(c)(4)(D) (investment in state obligations in federal s&l's home state); and 12 USC 1469 (investment in state housing corporations).

Congress could have preempted state due on sale law just as it expressly directed federal law, or state law, would apply to certain matters. As the court below said:

> While the Congress [in HOLA] has unequivocally expressed its preemptive design in relation to specific areas of savings and loan association activities, . . . [HOLA] makes no reference to the subject of due-on-sale clauses.

De la Cuesta v **Fidelity Fed Sav & Loan Ass'n,** 175 Cal Rptr 467, 471 (Cal App 1981). **See also Panko** v **Pan American Fed Sav & Loan Ass'n,** 174 Cal Rptr 240, 244 (Cal App 1981), **appeal pending,** No. 81-922; **Holiday Acres No 3** v **Midwest Fed Sav & Loan Ass'n,** 308 NW2d 471, 476 (1981).

Many non-internal matters are obviously governed by state law. Federal s&ls are subject to local zoning, building code, and employment law. They must rely on detailed state law for their transactions -- local contract law for employees, and the UCC for commercial paper and letters of credit. And particularly, state real property law governs many aspects of mortgages --title transfer, lien recording, contract law for promissory notes and mortgages. Federal s&ls exercising due on sale clauses rely, as appellants here did, on the foreclosure procedure created by state law.

It is not surprising that the Board will often look to state law. Its chairman testified at the 1933 Congressional hearings considering the HOLA bill:

> A good many people think we ought to put all the state regulations, what they ought to do and all that kind of thing, in here. But that is left to regulation by the board, who will put the most expert building and loan authorities on it to provide those regulations, so that the regulations can be varied. In some states you have to deal with them one way and in other states another way, and we want the

> **latitude allowed to fit the regulations of the board and the associations to the state law** and the different needs.

Hearings on HOLA, HR 4980, before House Comm. on Banking and Currency, 73d Cong., 1st Sess. 7 (April 20, 1933). (Emphasis added.)

More recently, the Board acknowledged federal savings and loans are subject to some local law.

> The Board does not seek to regulate wholly unrelated matters of purely local concern, such as zoning for Federal association property, methods for recording title, etc., which are left by the Board to State and local authorities . . . .

In re Schott, Res No 75-647, p 17n6 (July 30, 1975). The Board expressly defers to state law in certain matters. **See, e.g.,** 12 CFR 545.8-3(c) (payment of interest on escrow accounts); 12 CFR 556.5(a)(2) (branching for federal s&ls).

Under this amalgam of federal and state law governing federal s&ls, we now examine the due on sale regulation under each preemption theory.

No Actual Conflict Exists
Between State And Federal Law

Preemption by conflict analysis is "a two-step process of first ascertaining the construction of [the state and federal laws] and then determining the constitutional question whether they are in conflict." **Kalo Brick,** 450 US at 317; **Perez** v **Campbell,** 402 US 637, 644 (1971). **Accord, Jones,** 430 US at 526. In such an analysis "the proper approach is to reconcile 'the operation of both statutory schemes with one another rather than holding [the state scheme] completely ousted.' " **DeCanas,** 424 US at 357n5; **Merrill Lynch,** 414 US at 127; **Silver,** 373 US at 357; **accord, Exxon Corp** v **Maryland,** 437 US 117, 130-131 (1978). An

actual conflict exists if "compliance with both federal and state regulations is a physical impossibility . . . ," **Ray**, 435 US at 158; **Florida Lime**, 373 US at 142-143, or when the state statute "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." **Kalo Brick**, 450 US at 317; **Ray**, 435 US at 158; **Jones**, 430 US at 526, 540-541; **DeCanas**, 424 US at 363; **Perez**, 402 US at 649; **Florida Lime**, 373 US at 141; **Hines** v **Davidowitz**, 312 US 52, 67-68 (1941).

The federal regulation and state law are not in conflict. The federal regulation concerns when a federal s&l **may** include a due on sale clause in a mortgage instrument and when a federal s&l **may** exercise it. The state law limits restraints on alienation, including, in certain circumstances, exercise of due on sale clauses. Both the federal and state rules can be reconciled and given effect since neither is an absolute rule. California law does **not** hold due on sale clauses absolutely unenforceable. It merely establishes a "reasonable" test under which the lender must show its security is impaired. Similarly, the federal regulation is entirely permissive. It neither mandates the inclusion, nor the exercise, of a due on sale clause. The regulation states a federal s&l has the "power to include" the clause which it can exercise "at its option." **See Columbia Plaza Ltd Partnership** v **Cowles**, 403 F Supp 1337, 1343 (D DC 1975) ("Moreover, since the federal standard is permissive rather than mandatory, there is no 'impossibility of dual compliance' with the two statutes, [citing **Florida Lime**]."). Moreover, the federal regulation states that exercise is "exclusively" governed by the contract as are all "rights and remedies."

No Dominant Federal Interest Or
Pervasive Regulatory Scheme Exists

HOLA did **not** occupy the entire field for federal s&ls. Many aspects of federal s&ls are governed by state law -- expressly in the statute, expressly in regulations, and in practice throughout the system. **See, eg, Gulf Fed Sav & Loan Ass'n** v **Federal Home Loan Bank Board**, 651 F2d 259, 266 (CA5 1981) (federal law

governs internal management of federal s&ls, but not contractual relationships between s&l and borrowers).

Since no wholesale preemption exists, the issue here is the more limited one of whether state law on due on sale is preempted. The question is where along the continuum of balance between federal and state interests this falls. In looking for a dominant federal interest or pervasive federal scheme, we must consider not just federal s&ls but the entire federal involvement with mortgage financing and financial institution regulation.

First, HOLA itself doesn't even hint preemption was intended and, if anything, supports no preemption. It is dominated by provisions for internal controls of the federal s&ls it creates.

Second, the Board's regulation does not establish a pervasive regulatory scheme for due on sale clauses. The regulation merely addresses contract terms. Including and exercising the clause are both permissive. Moreover, the Board encourages waiving the clause on occasion. The Board's regulation says: "The Board believes there may be (in addition to the circumstances prescribed in §545.8-3(g) in which exercise of a due-on-sale clause is prohibited) situations in which it will be appropriate for a Federal association to waive" exercise of the due on sale clause. 12 CFR 556.9(c). The policy statement goes on to encourage federal savings and loans to "consider waiving [the exercise of a due on sale clause] in cases of extreme hardship to the existing borrower." **Id.**

Third, the Board has not identified or created a dominant federal interest requiring national uniformity. The Board stated the absence of due on sale clauses in federal s&ls' mortgages would cause a substantial reduction of cash flow and net income, impairing their ability to sell their mortgages in the secondary market. 41 Fed Reg 6285 (1976). But since these stated concerns about financial stability were not sufficient to move the Board to **require** due on sale clauses in all federal s&l mortgages, the federal interest is not as dominant as the Board would have

us believe. **De la Cuesta,** 175 Cal Rptr at 475; **Panko,** 174 Cal Rptr at 246; **Holiday Acres,** 308 NW2d at 479. Marketplace practices further show there is no dominant federal interest requiring national uniformity. Many federal s&ls do not enforce the clause. (This appeal is from cross motions for summary judgment. The Court may take judicial notice of the diversity among federal s&ls or remand if this fact is material.)

Finally, other federal agencies do not purport to preempt state due on sale law as the Board does. Only in 1981 did the Comptroller of the Currency authorize national banks to exercise due on sale for assumptions of newly-authorized adjustable rate mortgages for such banks. 46 Fed Reg 18932 (1981). And the Comptroller's 1981 proposed regulation for all mortgages held by national banks is prospective in effect and defers to state law limiting enforcement of due on sale clauses before the effective date. Proposed 12 CFR 30.1, 46 Fed Reg 46966 (1981). The National Housing Act has an express statement of Congressional intent contrary to the Board's policy.

> It is the intent of Congress that no sale of a dwelling on which a mortgage is insured under this chapter . . . shall be made, while such mortgage is so insured, on terms less favorable to the purchaser as to amortization, retirement, foreclosure, or forfeiture than those contained in such mortgage.

12 USC 17011. Under this policy VA and FHA-insured mortgages held by federal s&ls are all assumable.

The practices of the organizations that created the uniform mortgage due on sale clause form in issue here further confirm a lack of dominant federal policy. The Federal National Mortgage Association ("Fannie Mae"), a federally chartered corporation, is the nation's largest single supplier of home mortgage funds and currently owns about 2 million home mortgages. Until long after the Board adopted the regulation, it did not exercise due on sale even where state law permitted it. It

now exercises the clause only where law permits and only for mortgages it bought after November 10, 1980 or where there is an institutional "wraparound" or second mortgage. Fannie Mae still buys mortgages from the many states with local law like California as long as they have an optional shorter term "balloon" provision. Preemption of state law regarding due on sale has never been a factor in the market availability of this major source of secondary financing. The Federal Home Loan Mortgage Corporation does not raise the interest rate on assumptions. However, it requires all of the uniform clauses, such as due on sale, in the document, so the instruments are fungible.

The lack of federal uniformity in due on sale matters contrasts sharply with other areas of federal regulatory uniformity for financial institutions. One such area is the unified regulation of interest rates paid to depositors by financial institutions that are federally-regulated, members of the Federal Reserve System, or FDIC insured. 12 USC 3501 **et seq.** The same legislation uniformly preempts state usury laws. 12 USC 85 (national banks); 12 USC 1730g(a) (savings and loans insured by FSLIC); 12 USC 1785(g)(1) (federally-insured credit unions); 12 USC 1831d(a) (state-chartered banks insured by the FDIC); 12 USC 1735f-7 (certain federally-insured mortgages). This statute establishes a uniform federal policy for federally-regulated financial institutions. By contrast, no legislation or regulation uniformly regulates the use of due on sale clauses by federally-regulated financial institutions.

No Express
Preemption Exists

Neither HOLA nor the regulation expressly exempts state law governing due on sale. The statute merely grants general regulatory authority. 12 USC 1464(a)(1). The Board relies on its preamble to the due on sale regulation and a 1981 policy statement. 41 Fed Reg 18287 (1976) and 12 CFR 556.9(f)(2) (1981).

Neither provide a basis for express preemption.

The preamble and 1981 policy statement are merely interpretive rules, and this Court is not required to give them effect. The preamble was part of the introductory language preceding the substantive regulation when it was published. 41 Fed Reg 18287 (1976). It is not part of the regulation itself and was not codified. The new policy statement codifies what was said in the preamble. The Board's resolution promulgating it admits it is only a "general statement of policy," Res No 81-409, p2 (July 23, 1981). A substantive regulation, using the notice and comment procedure of the Administrative Procedure Act, 5 USC 553(b) and (c), has the force of law. **Chrysler Corp v Brown**, 441 US 281, 295-296, 302 (1979). The preamble and new policy statement, not using these procedures, are at best "interpretive rules," 5 USC 553(b)(A), and do not have the force of law. **Chrysler Corp**, 441 US at 315. An interpretive rule is simply an agency's opinion. It is particularly significant that, in spite of the challenges all across the country to the Board's substantive regulation, the Board chose in 1981 not to amend the 1976 substantive regulation. It simply issued a policy statement restating its opinion about the regulation's effect.

Since this Court is not required to give effect to the preamble and the new policy statement, it should not here. The weight depends, in part, on the validity of the agency reasoning and its consistency with other agency pronouncements. **St Martin Evangelical Lutheran Church v South Dakota**, 68 L Ed 2d 612, 621n13 (1981); **General Elec Co v Gilbert**, 429 US 125, 141-142 (1976); **Skidmore v Swift & Co**, 323 US 134 (1944). We have already shown the inconsistency of these policy statements with every other relevant factor on preemption.

No Preemption Exists For Deeds
of Trust Before June 8, 1976

The previous preemption discussion related to present law

after the effective date of the Board's due on sale regulation and its accompanying preamble. Even if we are wrong as to present law, no preemption exists as to deeds of trust **before** the Board's due on sale regulation.

The only even arguable basis for pre-1976 preemption is a previous Board regulation which said that mortgages of a federal s&l "shall provide for full protection to the Federal association," 12 CFR 545.6-11 (1975), and a Board resolution that interprets the old regulation as preempting state law. **In re Schott,** Res No 75-647 (July 30, 1975).

The Board's analysis in **Schott** concedes there was then no regulation dealing "specifically and exclusively" with due on sale, but notes its annual audit of federal s&ls includes loan document review where such clauses are included in mortgages. **Id.** at 13. The opinion states that "this," presumably referring to a loan document examination, plus the "pervasive regulatory scheme" (which simply does not exist), and "particularly" the "full protection" regulation is "sufficient" regulatory action to preempt the field. **Id.** at 13-14.

Turning to the "full protection" regulation itself, the Board further concedes it is in "general" terms and assumes arguendo there may be "gaps in the general subject matter." **Id.** at 15. It concludes such "gaps" can be "fleshed out" by additional regulations (irrelevant here before June 8, 1976), interpretive opinions such as **Schott,** or federal common law determined by courts. **Id.**

The Board in **Schott** incredibly relied for its "fleshed out" analysis primarily on a decision which disregarded and set aside the Board's interpretation of one of its own regulations and instead applied "federal common law." **Murphy** v **Colonial Fed Sav & Loan Ass'n,** 388 F2d 609 (CA 2 1967). It was not even a preemption case. The other decision the Board cited simply held that, on the issue in **Murphy,** the Board's later action filled the

gap by adopting a regulation on point. **Kupiec v Republic Fed Sav & Loan Ass'n,** 512 F2d 147 (CA 7 1975). Nothing proffered by the Board explains why its general regulation should be given preemptive effect in the due on sale area.

CONCLUSION

Because there is no basis for preemption of California law governing due on sale clauses, the decision below should be affirmed.

Respectfully submitted,

HYMAN, GURWIN, NACHMAN,
FRIEDMAN & WINKELMAN

By: _____
IRWIN M. ALTERMAN

And: _____
RICHARD D. BISIO

Attorneys for the Consumer's Committee to Protect Mortgage Rights

Dated: March 26, 1982.

CERTIFICATE OF SERVICE

STATE OF MICHIGAN)
)ss.
COUNTY OF OAKLAND)

I, IRWIN M. ALTERMAN, being first duly sworn, certify that on March 26, 1982 forty (40) copies of Amicus Curiae Brief Of The Consumer's Committee To Protect Mortgage Rights were mailed by first class mail, postage prepaid, to the Clerk of the United States Supreme Court, No. 1 First Street, N.E., Washington D.C. 20543. I further certify that on March 26, 1982 three (3) copies of said Amicus Curiae Brief Of The Consumer's Committee To Protect Mortgage Rights were mailed by first class mail, postage prepaid, to each of the following counsel of record at the addresses indicated:

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I further certify that all parties required to be served have been served.

_____

Irwin M. Alterman

Subscribed and sworn to before me
this 26th day of March, 1982

_____

Geraldine F. Habitz
Notary Public
Wayne County, Michigan
Acting in Oakland County, MI
My Commission Expires: 2/19/84

Amicus Brief

7

No. 81-750

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IN THE
Supreme Court of the United States

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
Appellants.

v.

REGINALD D. de la CUESTA, *et al.*,
Appellees.

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FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,
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v.

JOHN D. WHITCOMBE
Appellee.

On Appeal From The California Court Of Appeal
Fourth Appellate District

[redacted] THE CREDIT UNION NATIONAL ASSOCIATION, INC. [redacted] BRIEF AS AMICUS CURIAE [redacted] IN SUPPORT OF APPELLANTS' POSITION

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MOTION OF THE CREDIT UNION NATIONAL ASSOCIATION, INC. FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE IN SUPPORT OF APPELLANTS' POSITION

To the Honorable, the Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The Credit Union National Association, Inc. respectfully moves, pursuant to Rule 36 of the Rules of this Court, for leave to file the attached brief as *amicus curiae* in support of Appellants' position. The Appellants have consented to the filing of such brief, and are in the process of preparing written consent. The Appellees have not, as yet, replied to our requests for consent. When written consents are received, they shall be promptly filed.

INTEREST OF THE CREDIT UNION NATIONAL ASSOCIATION, INC.

Credit Union National Association, Inc. is a nonprofit membership association that represents the interests of 11,334 Federally chartered and 7,785 state chartered credit unions through 52 state and area credit union leagues.

In 1934 Congress enacted the Federal Credit Union Act.[1] The Act authorizes the National Credit Union Administration Board to "prescribe rules and regulations" for the administration of Federal credit unions. 12 U.S.C. § 1766(a). The National Credit Union Administration Board's general rulemaking authority is supplemented by specific authority to regulate real estate loans granted by Federal credit unions, 12 U.S.C. § 1757(5)(A)(i), the amortiztion of loans granted by Federal credit unions, 12 U.S.C. § 1757(5)(A)(ix), and the sale of loans granted by Federal credit unions, 12 U.S.C. § 1757(13).

The enactment of Public Law 95-22 in 1977 empowered Federal credit unions to make residential real estate loans. Pursuant to this authority the National Credit Union Administration Board issued extensive regulations governing the real estate lending practices of Federal credit unions. 12 C.F.R. § 701.21-6 (1978), 43 Fed. Reg. 14923 (1978) *revised in* 46 Fed. Reg. 38676 (1981) (*to be codified in* 12 C.F.R. § 701.21-6). (Appendix pp. 3a - 5a). These regulations *require* the use of the standard FNMA/FHLMC Uniform Mortgage Instrument, including clause 17, the due on sale clause (12 C.F.R. § 701.21-6(b)(7)).

As of December 31, 1981, Federal credit unions were serving more than 26.4 million members nationwide. Many of these Federal credit unions operate on a multistate basis without

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[1] 12 U.S.C. § 1751 *et seq.*

regard to state branching,[2] usury[3] or substantive lending laws[4] under the Federal Credit Union Act's broad preemptive scope. Pursuant to the regulations issued by the National Credit Union Administration Board, Federal credit unions, since 1978, have entered the residential mortgage market and, as of December 1980 (the last date for which statistics are available), the total real estate loans for all Federal credit unions amounted to more than 1.5 billion dollars. This investment, in only two years, represents 4.7 percent of all Federal credit union loans.

The controversy in the cases before this Court regarding the preemptive authority of the Federal Home Loan Bank Board has created a chilling effect on Federal credit union mortgage financing. Federal credit unions everywhere, and especially Federal credit unions in the state of California, are uncertain as to whether Federal or state law governs the enforceability of the due on sale clauses that *must* appear in all Federal credit union mortgages. Unlike other lenders, Federal credit unions may make loans only to members and, therefore, violate statutory membership limitations if a mortgage loan is assumed by a nonmember. 12 U.S.C. § 1757(5).[5]

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[2] 12 U.S.C. §§ 1752(9), 1757.

[3] See, *e.g.*, *Christian* v. *Atlanta Army Depot Federal Credit Union*, 140 Ga. App. 277, 231 S.E.2d 7 (1976); *Brooklyn Jenapo Federal Credit Union* v. *Schucher*, 258 N.Y.S.2d 348 (S.Ct. 1963); *McAnally* v. *Ideal Federal Credit Union*, 428 P.2d 322 (Okla. 1967); *Birdwhistell* v. *Y-12 Employees Federal Credit Union*, 57 Tenn. App. 621, 422, S.W.2d 896 (1968).

[4] See, *e.g.*, 46 Fed. Reg. 38676 (1981) (*to be codified in* 12 C.F.R. § 701.21-2(b)), authorizing variable rate consumer loans and expressly preempting "any state law purporting to address the subject of a Federal credit union's ability or right to make variable rate consumer loans or to directly or indirectly restrict such ability or right."

[5] At least one Federal credit union in California has attempted to have the enforceability of its due on sale clause judicially determined. *Mission Federal Credit Union* v. *National Credit Union Administration, et al.*, CV#81-1033-S(S.D. Cal. 1982) *(dismissed "as an exercise of the Court's discretion")* (App. p. 1a).

The Credit Union National Association, Inc. is therefore very concerned with the resolution of the question presented in this case. The Appellants have argued persuasively that the Home Owners' Loan Act of 1933 (HOLA) was broadly drafted by Congress to permit the Federal Home Loan Bank Board to design a regulatory scheme that governs virtually every aspect of a Federal savings and loan association "from its cradle to its corporate grave."[6] Federal credit unions and Federal savings and loan associations were created by Congress in the economic environment of the 1930's. Both types of institutions, borrowing from the Federal Credit Union Act's legislative history, were authorized so that "all parts of the country . . . might have the benefit of [this] system . . . [and] a law [was adopted] that would permit the creation of these instituions wherever they might be needed." 78 Cong. Rec. 12224 (1934) (remarks of Rep. Luce (R-Mass.)).[7]

Federal credit unions, since adoption of the Federal Credit Union Act, have looked to their regulatory agency, the National Credit Union Administration, for substantive as well as oper-

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[6] *California* v. *Coast Federal Sav. & L. Ass'n*, 98 F.Supp. 311, (S.D. Cal. 1951).

[7] Representative Luce (R-Mass.), in response to a question from Representative Beck (R-Pa.) as to the "grant of power" under which the legislation was justified, concluded that "[I]n passing the law for the Federal building and loan associations we did the same thing. . . ." 78 Cong. Rec. 12225 (1934). Representative Luce also explained the background of credit unions and need for Federal legislation to the House as follows:

> The growth of the [credit] union has been a battle, a long, hard battle. It has been a battle between the men, on the one hand, who have taken interest in their fellows and the loan sharks on the other. The loan sharks do a small-loan business which in the aggregate runs up into the billions of dollars annually. The usury laws permit a charge in most of the States of 42 percent a year. In this depression in a few States it has been dropped down to 36 percent a year. This outrageous state of affairs has brought great loss and hardship to those whose means are small, yet whose necessities are just as great as those of us who are more prosper-

ational and procedural authority. Variable rate lending, as well as secondary market and other activities are premised on the preemptive regulatory authority granted the National Credit Union Administration by the Federal Credit Union Act. Unless this Court provides clear guidance, in the wake of the lower court's decision, Federal credit unions, Federal savings and loan associations and, ultimately the courts, will encounter substantial problems as attempts are made to determine which interstices in the federal scheme are filled by state law.[8]

WHEREFORE, it is respectfully requested that the Court grant the Credit Union National Association, Inc. leave to file the attached brief as *amicus curiae* in support of the appellants' position.

Respectfully submitted,

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February 26, 1982

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ous. In various States of the Union the loan sharks have *been able to control the legislatures* so that they have secured the passage of laws making it almost impossible to form one of these credit unions. For instance, by placing the incorporation fee so high that the unions cannot pay it, the unions have been unable to organize. In *10 States they have thwarted entirely* the organization of these unions by preventing the passage of laws permitting incorporation. 78 Cong. Rec. 12224 (1934) (emphasis added).

[8] See, *e.g.*, *Kimball* v. *National Bank of North America, N.A.*, 468 F.Supp. 1069 (E.D.N.Y. 1979), *aff'd mem.*, 614 F.2d 1288 (2d Cir. 1980).

QUESTION PRESENTED

Whether the Home Owners' Loan Act of 1933 (12 U.S.C. 1461 *et seq.*) and the Federal Home Loan Bank Board regulations promulgated thereunder pertaining to the use of "due on sale" clauses in mortgages written by federally chartered savings and loan associations, preempt a California statute prohibiting restraint on alienation of property.

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Appellee.

On Appeal From The California Court Of Appeal
Fourth Appellate District

BRIEF OF CREDIT UNION NATIONAL ASSOCIATION, INC. AS AMICUS CURIAE

The Credit Union National Association, Inc. submits this brief, as *Amicus Curiae*, in support of the position of the Appellants, Fidelity Federal Savings and Loan Association, et al., in this appeal from the decision by the California Court of Appeal.

I.

SUMMARY OF ARGUMENT

The Home Owners' Loan Act of 1933 (HOLA) was enacted to create a uniform set of powers and rules under which Federal savings and loan associations were to provide home financing. Federal savings and loan associations were needed to prevent thousands of home owners from losing their homes. Congress evidenced a strong intent to free these new Federal financial institutions from the vagaries of state law by providing full authority to their regulatory agency, the Federal Home Loan Bank Board, to require these new Federal financial institutions to follow the "best practices" in lending and thrift. 12 U.S.C. § 1464(a).

The Federal Home Loan Bank Board has unequivocally determined that restrictions on the use of due on sale clauses are inconsistent with the "best practices" in lending. 12 C.F.R. § 545.8-3(f). See also, Appellants' Jurisdictional Statement (J.S. App.), p. 45a. The authority under HOLA to exercise the regulatory power to preempt the operation of state law is clear. The California Court of Appeal's failure to enforce due on sale clauses in mortgages made by Federal savings and loan associations creates an irreconcilable conflict between federal and state law. Further, the FNMA/FHLMC Uniform Instrument specifically authorizes the use of a due on sale clause to raise interest rates, notwithstanding a separate clause providing that the Deed of Trust shall be governed by the law of the jurisdiction in which the property is located.

II.

ARGUMENT

A. Federal Home Loan Bank Board Regulations Preempt State Due On Sale Restrictions

The Congressional power to authorize the Federal Home Loan Bank Board to issue regulations that supercede state law originates in the Supremacy Clause of the Constitution of the United States (Art. VI, cl. 2). The determination as to whether Congress provided the preemptive power to the Federal Home Loan Bank Board is a question of intent. *Jones* v. *Rath Packing Co.*, 430 U.S. 519, 525 (1977). This preemptive intent may be express, *Rice* v. *Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947), implied from an overriding federal concern or the pervasive nature of the legislation, *id.*, or implied when the state law either conflicts with or creates an obstacle to the accomplishment of a valid Congressional purpose, *Hines* v. *Davidowitz*, 312 U.S. 52, 67 (1940).

The Congressional solution to the problems faced by thrifts in the 1930's was to establish a nationwide system of *Federal* savings and loan associations which would follow the "best practices" of thrift and lending as laid out by the Federal Home Loan Bank Board.[1] This emphasis on uniformity of nationwide practice has resulted in a series of judicial opinions that, when read together, stand for the proposition that Congress intended, through the creation of the Board, a pervasive scheme of federal regulation and that federal law govern the operation of the system and its members.[2]

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[1] 12 U.S.C. § 1464(a).

[2] *California* v. *Coast Federal Sav. & L. Ass'n*, 98 F.Supp. 311 (S.D. Cal. 1951); *Lyons Sav. & L. Ass'n* v. *Federal Home Loan Bank Board*, 377 F.Supp. 11 (N.D. Ill. 1974); *Meyers* v. *Beverly Hills Federal Sav. & L. Ass'n*, 499 F.2d 1145 (9th Cir. 1974); *Kaski* v. *First Federal Sav. & L. Ass'n of Madison*, 72 Wis. 2d 132, 240 N.W. 2d 367 (Wis. 1976); *Murphy* v. *Colonial Federal Sav. & L. Ass'n*, 388 F.2d 609 (2d Cir. 1967); *Kupiec* v.

The breadth of federal authority over Federal savings and loan associations is well illustrated in *Conference of Federal Savings and Loan Associations* v. *Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980) where the court stated:

> In our judgment the regulatory control of the Bank Board over Federal savings and loan associations is so pervasive as to leave no room for state regulatory control. As this court noted in *Meyers* v. *Beverly Hills Federal Savings and Loan Ass'n.* . . .:
>
> > "Pursuant to its valid statutory authority, the Federal Home Loan Bank Board has promulgated comprehensive regulations covering all aspects of every Federal savings and loan association from its cradle to its corporate grave." *People of State of California* v. *Coast Federal Savings and Loan Ass'n.*, . . .
>
> The broad regulatory authority over the Federal associations conferred upon the Bank Board by HOLA does wholly preempt the field of regulatory control over these associations.

The California Court of Appeal was bound to follow this Court's summary affirmance in *Stein* but did not do so. Furthermore, the lower court ignored cases on point that hold that regulations intended by a federal agency to displace state law will do so, provided the regulations are not inconsistent with general legislative objectives. See, *e.g.*, *United States* v. *Shimer*, 367 U.S. 374 (1961).

The lower court's opinion pivots, at least partially, on the failure of Congress in HOLA to make explicit reference to the

---

Republic Federal Sav. & L. Ass'n, 512 F.2d 147 (7th Cir. 1975); *Greenwald* v. *First Federal Sav. & L. Ass'n of Boston*, 446 F.Supp. 620 (D. Mass. 1978), *aff'd* 591 F.2d 417 (1st Cir. 1979); *cf. Derenco, Inc.* v. *Benj. Franklin Federal Sav. & L. Ass'n*, 517 P.2d 477 (Ore. 1978); *Conference of Federal Sav. & L. Ass'n, et al.*, v. *Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980).

subject of due on sale clauses. (J.S. App. 7a). Such specifics are rarely legislated. The lower court reasoned that since Federal savings and loan associations were subject to state laws pertaining to real property and mortgages (for example, title and foreclosure proceedings) that Congress had not intended to "occupy the field" and that express or implied preemption was not present, absent a direct conflict between state and federal law. (J.S. App. 11a). The lower court's argument improperly narrowed the scope of its preemption inquiry which should have centered on whether the Bank Board's due on sale regulations were within the Bank Board's Congressionally mandated authority. *United States* v. *Shimer*, 367 U.S. 374 (1961).

The lower court attempts to justify its narrow preemption analysis, in part, by arguing that the federal scheme established by HOLA only authorizes Bank Board regulations covering "internal" operations of Federal savings and loans associations. The federal scheme, however, must be said to include the authority to order the relationship (including use of due on sale clauses) between an association and its customers. See, *e.g.*, *Meyers* v. *Beverly Hills Federal Savings and Loan Association*, 499 F.2d 1145 (9th Cir. 1974) (prepayment penalties); *Kaski* v. *First Federal Savings & Loan Association of Madison*, 72 Wis. 2d 132, 240 N.W. 2d 367 (1976) (interest rate escalation clause).

It is clear that the federal scheme established by HOLA has been drastically undermined by the lower court's decision. The Bank Board was provided authority to preempt state law that would prevent Federal associations from adhering to the "best practices" in lending. 12 U.S.C. § 1464(a).

B. Conflict Exists Between State and Federal Law

California law holds that enforcement of a due on sale clause is an unreasonable restraint upon alienation "unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default."

Wellenkamp v. *Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978). Federal law clarifies that a Federal savings and loan association has the power to include due on sale clauses in mortgages, giving Federal associations the option to accelerate payment of the indebtness if property is sold without the prior written consent of the lending association. 12 C.F.R. § 545.8-3(f). The federal law does impose limitations upon the exercise of due on sale clauses (12 C.F.R. § 545.8-3(g)), but such exercise by a Federal savings and loan association is not made contingent upon a finding of impairment to security or risk of default.

Yet, despite the obvious fact that federal and state law conflict in the plainest sense, the court below has concluded that California due on sale law in no way infringes upon or is otherwise incompatible with Bank Board regulations because California law does not invalidate the exercise of all due on sale clauses. (J.S. App. 14a). Apparently, according to the court below, finding even one condition under which the state law does not prevent the exercise of a federally authorized privilege meets the *Jones* test, *Jones, supra*, at 526, that state law "does not stand as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."

The lower court's approach to preemption, if allowed to stand, represents a serious challenge to all federal regulatory schemes. Absent an express Congressional statutory statement that state law shall not apply, any state law that did not completely preclude the operation of a federal regulation could be upheld. This approach to preemption is precisely the result Congress intended to preclude when it adopted HOLA in 1933.

C. Paragraph 15 Of The FNMA/FHLMC Uniform Instrument Does Not Permit The Lower Court To Ignore Federal Law Enforceable In The State

The court below found further support for its decision because of language contained in Paragraph 15 of the FNMA/

FHLMC Uniform Instrument. A portion of that paragraph states that "[T]his Deed of Trust shall be governed by the law of the jurisdiction in which the property is located." It was the lower court's conclusion that "such language expresses an unmistakable intention that state law shall govern the interpretation, validity and enforcement of the loan-security instrument." (J.S. App. 19a).

The long standing law of the land remains that state law includes preemptive federal law. *Hauenstein* v. *Lynham*, 100 U.S. 483 (1880). The "law of the jurisdiction" clause, as contained in the Whitcombe and Moore trust deeds, therefore simply expresses an unmistakable intention that state law shall govern. *But state law includes federal preemptive law.*

While the lower court apparently recognized the *Hauenstein* rule, it dismissed its application on the basis of an alleged, though nonexistent, inconsistency with the standard "severability clause" that follows the "law of the jurisdiction clause" in the above-described paragraph 15. The lower court stated, in relevant part:

> Of course, reference to state law in some contexts may include reference to the federal law enforceable in the state, but to accept that interpretation here would entirely overlook the next sentence in paragraph 15 referring to a possible conflict of provisions or clauses of the deed of trust "with applicable law." *If defendants and amicus were said to be correct that state law has been preempted by federal occupation of the field, there would be no "applicable law" other than the federal law and therefore no provision or clause of the deed of trust could be in conflict "with [the] applicable law."* The same nonsensical result.. . ." (J.S. App. 20a) (emphasis added).

Little can be said in support of the lower court's rationale except that it was quite correct in characterizing the result as nonsensical. In apparently overlooking the fact that a clause in the trust deed could conflict with state law, including preemp-

tive federal law in a number of contexts not confined to the due on sale issue, the court clearly misunderstands the purposes of a standard severability provision in the FNMA/FHLMC Uniform Instrument. Paragraph 15 is simply not intended, nor can it be construed, to make state law superior to regulations issued by the Federal Home Loan Bank Board.

III.

CONCLUSION

For all the foregoing reasons, the Credit Union National Association, Inc. urges the Court to clearly enunciate that the relevant regulations promulgated by the Bank Board concerning due on sale clauses, preempt state law.

Respectfully submitted,

BRUCE O. JOLLY, JR.
Washington Counsel
Counsel of Record

February 26, 1982

CERTIFICATE OF SERVICE

I, Bruce O. Jolly, Jr., Attorney for the Credit Union National Association, Inc. and a member of the Bar of the Supreme Court of the United States, HEREBY CERTIFY and declare that I am over the age of 18 years and not a party to the within cause. My business address is 1730 Rhode Island Avenue, N.W., Suite 810, Washington, D.C. 20036; that on February 26, 1982 three copies of the foregoing Motion, Brief and Appendix were furnished, on behalf of the Credit Union National Association, Inc., by air mail, postage prepaid, to Hahn Cazier & Leff, 555 South Flower Street, Forty-Second Floor, Los Angeles, California 90071, Attorneys for Appellants, and to Fred Crane, A Professional Corporation, 3576 Arlington Avenue, Suite 105, Riverside, California 92506, Attorney for Appellees. I further certify that all parties required to be served have been served.

This declaration was executed on February 26, 1982 at Washington, D.C.

I declare under penalty of perjury that the foregoing is true and correct.

Attorney for
Credit Union National Association, Inc.
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1730 Rhode Island Avenue, Suite 810
Washington, D.C. 20036

Appendix

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF CALIFORNIA

No. 81-1033-S(M)

MISSION FEDERAL CREDIT UNION,

Plaintiff,

v.

NATIONAL CREDIT UNION ADMINISTRATION BOARD, DAVE G. MARTINEZ, ELIZABETH A. MARTINEZ, JOHN MC LEOD and JENNIFER M. MC LEOD,

Defendants.

ORDER OF DISMISSAL

The motion of defendants JOHN MC LEOD, JENNIFER M. MC LEOD, DAVE G. MARTINEZ, and ELIZABETH A. MARTINEZ for dismissal of the Complaint for Declaratory Judgment came on regularly for hearing on Monday, January 11, 1982, before the Honorable Edward J. Schwartz, Judge presiding; plaintiff appearing by and through its attorney Pizer, Michaelson & Moore and Randy Moore, Esq.; defendant NATIONAL CREDIT UNION ADMINISTRATION BOARD appearing by and through its attorney Stephen V. Petix, Assistant U.S. Attorney; and defendants JOHN MC LEOD, JENNIFER MC LEOD, DAVE G. MARTINEZ and ELIZABETH A. MARTINEZ appearing by and through their attorney Laurence C. Baldauf, Jr.; and the Court having reviewed the file, having heard and considered the arguments of counsel, and being fully advised;

NOW THEREFORE, IT IS HEREBY ORDERED AND ADJUDGED:

That the motion for dismissal of defendants JOHN MC LEOD, JENNIFER M. MC LEOD, DAVID G. MARTINEZ and ELIZABETH A. MARTINEZ is hereby granted, and plaintiff's Com-

plaint for Declaratory Relief is hereby ordered dismissed as to all parties, as an exercise of the Court's discretion.

Dated: *January 29, 1982.*

EDWARD J. SCHWARTZ
Judge of the United States
District Court

TITLE 12 — BANKS AND BANKING

CHAPTER VII — NATIONAL CREDIT UNION ADMINISTRATION

PART 701 — ORGANIZATION AND OPERATIONS OF FEDERAL CREDIT UNIONS

FINAL RULE — REAL ESTATE LENDING

EFFECTIVE DATE: This regulation is to be effective May 8, 1978.

Part 701.21-6 Real Estate Lending.

(b) Federal credit unions with assets of $2,000,000 or more, or any other Federal credit union with prior written consent of the Administration, may originate loans secured by first liens on residential real property, with maturities in excess of 12 years and not exceeding 30 years within the limitations of written policies adopted by the board of directors provided:

(7) The security instruments and notes shall be executed on the current revision of the FNMA/FHLMC Uniform Instruments for the jurisdiction in which the property is located. No prepayment penalty shall be allowed. In the case of an Insured or Guaranteed Loan these instruments shall be acceptable to the insuring or guaranteeing agency.

12 CFR Part 701

Fixed Rate Mortgage Loans

Agency: National Credit Union Administration.

Action: Final Rule.

Effective Date: July 22, 1981.

§ 701.21-6 Fixed rate mortgage loans.

* * *

(d) * * *

(1) Notwithstanding any state law to the contrary, in the case of a conventional loan a Federal credit union is required to include a due on sale clause in its loan instruments whereby the holder of a loan made by a Federal credit union may, at its option, declare immediately due and payable all of the sums secured by the security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the holder's prior written consent. In the case of an Insured or Guaranteed loan, a Federal credit union is not required to include a due on sale clause in its loan instruments unless it is acceptable to the insuring or guaranteeing agency.

(2) Notwithstanding any state law to the contrary, the holder of a loan made by a Federal credit union may exercise a due on sale clause, for example, because of unsatisfactory creditworthiness of the person to whom the property is to be sold or transferred or because of a need to increase the overall yield in its loan portfolio, unless:

(i) Exercise of the due on sale clause would be based on any of the following:

(A) Creation of a lien or other encumbrance subordinate to the security instrument;

(B) Creation of a purchase money security interest for household appliances;

(C) Transfer by devise, descent, or by operation of law upon the death of a joint tenant; or

(D) Grant of any leasehold interest of three years or less not containing an option to purchase; or unless

(ii) Prior to the transfer the holder and the person to whom the property is to be sold or transferred reach written agreement that the credit of such person is satisfactory to the holder and that the interest payable on sums secured by its security instrument shall be at such rate as the holder shall request.

(3) This section is being promulgated pursuant to the plenary and exclusive authority of the NCUA Board as set forth in Sections 107(5)(A)(i), 107(5)(A)(ix), and 107(13) of the Federal Credit Union Act to regulate, respectively, the real estate loans granted by Federal credit unions, the amortization of loans granted by Federal credit unions, and the sale of loans granted by Federal credit unions. This exercise of the Board's authority preempts state laws purporting to address the ability of the holder of a loan made by a Federal credit union to exercise its rights under a due on sale clause to raise interest rates on loans.

Amicus Brief

81

TION FILED
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No. 81-750

IN THE

SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

Appellants.

v.

REGINALD D. de la CUESTA, et al.,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

Appellants.

v.

ALPHONSO MOORE, et al.,

Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et. al.,

Appellants.

v.

JOHN D. WHITCOMBE

Appellee.

On Appeal From the California Court of Appeal
Fourth Appellate District

MOTION OF THE GEORGIA ASSOCIATION OF REALTORS®, INC. FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF IN SUPPORT OF APPELLEES' POSITION

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QUESTION PRESENTED

Whether the Federal Home Loan Bank Board was authorized by the Home Owners' Loan Act of 1933, 12 U.S.C. (& Supp. III) 1461 et seq., in adopting a regulation (12 C.F.R., Sec. 545.8-3) purporting to preempt a California statute prohibiting "restraints on alienation" of property, as applied to a "due-on-sale" clause in a mortgage written by a federal savings and loan association.

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IN THE

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OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

Appellants,

v.

REGINALD D. de la CUESTA, et al.,

Appellees.

On Appeal From the California Court of Appeal
Fourth Appellate District

MOTION OF THE GEORGIA ASSOCIATION OF REALTORS®, INC. FOR LEAVE TO FILE BRIEF AS AMICUS CURIAE AND BRIEF IN SUPPORT OF APPELLEES' POSITION

To the Honorable, The Chief Justice of the United States and the Associate Justices of the Supreme Court of the United States:

The Georgia Association of Realtors®, Inc. respectfully moves, pursuant to Rule 36 of the Rules of this Court, for leave to file the attached brief as amicus curiae in support of Appellees' position. Both the Appellees and Appellants have consented to the filing of such brief in writing, and their letters of consent are filed with the Court.

INTEREST OF THE GEORGIA ASSOCIATION OF REALTORS®, INC.

The Georgia Association of Realtors®, Inc. (GAR) is a non-profit trade association with almost 14,000 members, organized for the purpose of promoting and maintaining ethical standards among its members who are actively engaged in the business of representing buyers and sellers of real property in Georgia. GAR recognizes the difficulty Federal Savings and Loan Associations face in these inflated economic times, and understand their use of "consent-for-sale" or "due-on-sale" clauses in mortgage documents. GAR does not protest so much the practice of lenders, by contract, attempting to protect themselves against the caprice of inflation, but does protest the underhanded way in which it has been accomplished through the "consent-for-sale" or "due-on-sale" clauses.

The Georgia General Assembly has enacted legislation commonly referred to as "Georgia's Assumption Statute" and it is codified at *Ga. Code Ann.*, Sec. 67-3001 and 67-3002 (Ga. Laws 1979, p. 345). Under this statute, "due-on-sale" clauses are unenforceable in Georgia as unreasonable restraints on alienation unless the obligor requests in writing to be relieved of the underlying obligation. In the event the current obligor seeks to be relieved of the obligation, the lender may increase the interest rate. Georgia's Assumption Statute also allows the lender to investigate the credit worthiness of the prospective purchaser, and in the event of credit unworthiness, the lender has the right to disallow the assumption. This consumer protection legislation is limited to single family home loans of less than $100,000.00 and proscribes conduct of only those regularly engaged in lending mortgage money.

Additionally, GAR agrees with Appellee's view that federal preemption of State Law which has traditionally defined real property values would represent a form of federal control over states which threatens the system of federalism

and the individual liberties of its citizens, and was never intended by Congress when it enacted the Home Owners Loan Act (HOLA) of 1933, 12 U.S.C. 1461 et seq.

SUMMARY OF ARGUMENT

A multitude of future relationships between the State and the Federal Government as pertains to both real property law and contract law could be adversely affected by the Court's decision in this Appeal. More than one isolated instance of improper use of congressional power is at stake. A new form of federal regulation appears in the Federal Home Loan Bank Board's attempt to preempt State Law which must be rejected by this Court before it can become an entrenched practice leading to the potential demise of our federal system.

While it is Appellees' contention that Congress never intended to preempt State Law in the promulgation of HOLA, nonetheless, if that had been the intent of Congress, then Congress has mistakenly asserted its Commerce Power over a subject not intended to be reachable by the FRAMERS of our Constitution. The function of each State defining property rights within its borders is neither a form of interstate commerce, nor an activity affecting commerce in any constitutional sense, and is protected by the Tenth Amendment.

The regulation of the Federal Home Loan Bank Board wherein it attempted to authorize its member institutions to include due-on-sale clauses in their loan documents, 41 Fed. Reg. 18288, codified at 12 C.F.R. 545.8-3(f), also 46 Fed. Reg. 39123 (1981), can best be described as "commandeering federalism." By preempting State public policy in an area long reserved unto the States by Agency regulation or even by Congress itself would deprive the States of their independence and undermine their ability to function, as intended by the FRAMER in the federal system. The rights and liberties of the people, protected and preserved by the

plan of the Constitution, are likewise undermined by the shift of power to the Federal Government which results from the scheme of regulation reflected by a regulation such as the one under consideration. These writers in no way suggest or imply that Congress or a Federal Agency, acting congruent to Constitutional authority, cannot preempt State Law, U. S. Const., Art. VI, cl. 2.

However, our State Courts must be free to consider the particular equity of a given case and be left free to decide that a contractual right procured in an inequitable manner is unenforceable. Both our system of federalism and the Tenth Amendment present a barrier against the aggrandizement of congressional power as contemplated by the FHLBB regulation in question.

No justification for preempting State Law put forward by Appellants is adequate to warrant reversal of the lower courts' decision. Preemption of long standing state jurisdiction cannot be justified under the argument that failure to do so will wreck financial havoc on Federal Savings and Loan Associations caught in long-term, low yield mortgages. Why should the unsuspecting borrower be required to pay for the lender's mistaken economic projections as to the earning potential of its mortgage portfolio? This Court should not erode the rights of the little folks and grant a financial windfall to the financial giants.

ARGUMENT

A. WHEN ENACTING THE HOME OWNERS LOAN ACT (HOLA) CONGRESS DID NOT INTEND TO PREEMPT STATE REAL PROPERTY LAW LIMITING RESTRAINTS ON ALIENATION, NOR DID IT AUTHORIZE THE FEDERAL HOME LOAN BANK BOARD TO DO SO.

1. THE LAW OF PREEMPTION.

State law may be preempted by federal legislation only where Congress either intended preemption, or where a clear conflict exists between federal law and state law, *Ray v. Atlantic Richfield Co.*, 435 U.S. 151, 157-58 (1978), such as "where compliance with both federal and state regulation is a physical impossibility," *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963). This Court has repeatedly held that preemption is "not lightly to be presumed." *Schwartz v. Texas*, 344 U.S. 199, 202-03 (1952), cited with approval in *New York State Department of Social Services v. Dublino*, 413 U.S. 405, 414 (1973). Accord, *Exxon v. Governor of Maryland*, 437 U.S. 117, 132 (1978) ("the Court is generally reluctant to infer preemption"). See, generally, *Note, The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 Colum. L. Rev. 623, 649 (1975) ("the Burger Court decisions show a renewed emphasis on the state directed doctrine").

Sound policy reasons exist for such narrow application. If no preemption is found, Congress can always change the result by legislation. In fact the FHLBB has now requested Congress to do this in S.1720, but the outcome of this proposed legislation is in doubt. Erroneous preemption, however, leaves the states impotent to correct the situation.

See, *Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624, 643 (1973).

Courts have used a variety of expressions in determining the validity of a state law which attempts to regulate the same subject as a federal law, including "conflicting; contrary to; occupying the field; repugnance; difference; irreconcilability; inconsistency; violation; curtailment; and interference." None of these expressions, however, provides an infallible constitutional test or an exclusive constitutional yardstick. In the final analysis, no one crystal clear distinctly marked formula exists. See, e.g., *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) and *Pennsylvania v. Nelson*, 350 U.S. 497, 501-02 (1956). However, the two-part test set forth in *Florida Lime and Avocado Growers, Inc. v. Paul*, Supra and restated in *Head v. New Mexico Board*, 374 U.S. 424 (1963) is the clearest expression of constitutional philosophy.[1]

Thus, this Court has focused on the intent of Congress and the existence of conflict in determining whether there is preemption. Moreover, this Court has recently further restricted the application of the preemption doctrine where private property interests were involved. See, *Aronson v. Quick Point Pencil Co.*, 446 U.S. 257, 99 S. Ct. 1096, 59 L. Ed. 2d. 296, 301 (1979) ("Commercial agreements traditionally are the domain of state law."); *Butner v. United States*, 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136, 141-42 (1979) ("Property interests are created and defined by state law."). Federal law regulates the operation of federally chartered savings and loan associations while state law regulates real property transactions within the state. This has

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[1] In *Head*, this Court stated: "In areas of the law not inherently requiring national uniformity, our decisions are clear in requiring that state statutes, otherwise valid, must be upheld unless there is found "such actual conflict between the two schemes of regulation that both cannot stand in the same area, (or) evidence of a congressional design to preempt the field." *Id.* at 430.

been so since the enactment of HOLA and until the FHLBB regulation.

The fact that the Board's regulations specifically provide that they apply to "loans made after July 31, 1976" 12 CFR 545.8-3 (formerly 12 C.F.R. 546.6-11(f)) suggests that the application of state law to pre-regulation loans did not conflict with, nor obstruct any federal goals for more than four decades.

2. THE LEGISLATIVE HISTORY OF HOLA SUGGESTS CONGRESS DID NOT INTEND THAT THERE BE PREEMPTION.

The legislative history of HOLA not only does not suggest preemption but, on the contrary, suggests non-preemption.

The Federal Savings and Loan system was initiated "to provide local mutual thrift institutions which people may invest their funds and . . . to provide for the financing of homes," HOLA Section 5(a), 48 Stat. 128, 132 (1933), 12 U.S.C., Section 1464(a). Thus, the system of federal associations was intended not to deal with State real property and contract practices, but to fill the gap in home financing caused by the absence of local thrift associations in one-half the counties of the United States. *T. Marvell, The Federal Home Loan Bank Board*, 26 (1969). These federal associations, according to the first FHLBB Chairman, William L. Stevenson, were to be "*organized under a Federal Charter but will operate locally and be managed locally.*" S. Docs. 73-1, Vol. 9-90 (June 6, 1933). Congress did not choose to eliminate possible pernicious practices of States by the simple device of express prohibition or preemption by Federal Regulations. Rather, it provided an economic incentive to discourage these practices i.e., long term credit available from the Federal Home Loan Bank system, 47 Stat. 725

(1932), 12 U.S.C., Section 1421 et. seq., and the exchange of government bonds issued by HOLC for mortgage contracts.

The "pernicious practices" HOLC was designed to remedy included short-term lending and balloon payments. Ironically, the FHLBB now attempts to use Congressional efforts to eliminate those practices in their effort to save the due-on-sale clause, which, in effect, creates short-term lending and balloon payments.

HOLA does authorize the FHLBB to adopt regulations reflecting the "best practices of local mutual thrift and home-financing institutions in the United States." HOLA, Section 5(a), 12 U.S.C., Section 1464(a). However, such language does no more than provide standards for the enactment of its regulations. It does not even purport to establish exclusive regulatory powers for the Board.

That the Board may have exclusive authority with respect to some activities of the federal associations does not mean it has exclusive authority over all areas of regulation touching upon these institutions.[2]

Assuming that the comments of the first Board Chairman are relevant, he testified that the Board wanted "the latitude . . . to fit the regulations of the board and the associations to the states and the different needs." Hearings on HOLA, HR 4980, before House Comm. on Banking & Currency, 73rd Cong. 1st Sess. 7 (April 20, 1933) (Statement of William F. Stevenson, Chairman, Federal Home Loan Bank Board). Board Chairman Stevenson's comment suggests

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[2] This Court set forth this principle in *Kelly v. Washington*, 302 U.S. 1 (1937), where it stated:

"There is no constitutional rule which compels Congress to occupy the whole field. Congress may circumscribe its regulation and occupy only a limited field. When it does, state regulation outside the limited field and otherwise permissible is not forbidden or displaced." *Id.* at 10.

that HOLA gave the Board discretion to facilitate the federal associations' compatability with local law which would be applicable.

Congress, by statute, has expressly delineated the ways in which federal associations are permitted to deviate from state practices. For example, since HOLA's inception federal law exclusively governs the geographical radius in which federal associations may lend money, and the percentage of value of the security on which federal associations may lend. HOLA Section 5(c), 49 Stat. 128, 132 (1933) (current version at 12 U.S.C. Section 1464(c)). None of the express statutory provisions, however, impinges on state laws concerning real property, contracts or transfers of title, and none involves preemption in the sense of displacement of state law.

Moreover, nothing in HOLA addresses any aspect of the enforceability of federal associations' contracts with third parties. Presumably, if Congress had intended to preempt state contract law or a court's authority to apply equitable principles in a foreclosure action, it would have expressly so stated or, at a minimum, addressed the subject of contract law in HOLA, or created a total federal cause of action governed solely by the federal courts. It did neither.

Even assuming Congress had established a pervasive regulatory scheme, that would not result in preemption.[3]

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[3] This Court, in recently upholding various work rules of the New York Social Welfare Law as not preempted by federal law, stated:

"We reject, to begin with the contention that preemption is to be inferred merely from the comprehensive character of the federal work incentive provisions . . . . The subjects of modern social and regulatory legislation often by their very nature require intricate and complex responses from Congress, but without Congress necessarily intending its enactment as the exclusive means of

In sum, Appellants cannot point to any language in HOLA, or legislative history of HOLA, suggesting that Congress intended preemption.

3. CONGRESS DID NOT INTEND THAT STATE REGULATION OF LOCAL PROPERTY OR CONTRACTS BE PREEMPTED.

The internal affairs of Federal Savings and Loan Associations are regulated by the FHLBB pursuant to HOLA (12 U.S.C. 1461 et seq.). With this authority to regulate the "organization, incorporation, examination and operation" of the Federal Associations, the FHLBB has gone beyond mere regulation with adoption of the due-on-sale Regulation (12 C.F.R. 545.8-3(f)).

This regulation attempts to preempt traditional state land laws and contract laws. While some have said that the FHLBB regulates the association "from its cradle to its corporate grave;" just quoting the metaphor does not make it so, nor does it necessarily give any more authority to the Board. This impressive sounding metaphor can, therefore, be grossly misleading.

Any inquiry into whether Congress has "unmistakably . . . ordained" preemption (*Florida Lime & Avocado Growers, Inc. v Paul*, Supra, must consider that the subject, in this case — local land law — is traditionally regulated by the states.[4]

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meeting the problem." *New York State Department of Social Services v. Dublino*, 413 U.S. 405, 415 (1973).

[4] "It is true, too, that '[t]he great body of law in this country which controls acquisition, transmission, and transfer of property, and defines the rights of its owners in relation to the state or to private parties, is found in the statutes and decisions of the state. Even when federal general law was in its heyday, an exception was carved out for local laws of real property. Indeed, before *Erie*

Just recently, this Court held that the law of a state where property is located, rather than federal law, governs the right to rents collected during the period between a mortgagor's bankruptcy and the foreclosure sale of the mortgaged property.[5]

The Court has also recently noted in a preemption case that "commercial agreements traditionally are the domain of state law." *Aronson v. Quick Point Pencil Co.*, Supra.

These same considerations of federalism have given rise to federal restraint in analogous settings. For example, in *United States v. Yazell*, 382 U.S. 341 (1966), this Court held that where a federal agency (in *Yazell*, the Small Busi-

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R. Co. v. Tompkins, supra, this Court's opinions left open the possibility that even 'the United States, while protected by the Constitution from discriminatory state action, and perhaps certain other special forms of state control, was nevertheless governed generally in its ordinary proprietary relations by state law.' *United States v. Little Lake Misere Land Company, Inc.*, 412 U.S. 580, 591-92 (1973) (citations omitted.).

[5] In *Butner v. United States*, 440 U.S. 48, 99 S. Ct. 914, 59 L. Ed. 2d 136 (1979), this Court said:

"Property interests are created and defined by state law. Unless some federal interest requires a different result, there is no reason why such interests should be analyzed differently simply because an interested party is involved in a bankruptcy proceeding. Uniform treatment of property interests by both State and federal courts within a State serves to reduce uncertainty, to discourage forum shopping, and to prevent a party from receiving a 'windfall merely by reason of the happenstance of bankruptcy.' . . . The justifications for application of state law are not limited to ownership interests; they apply with equal force to security interests, including the interest of a mortgagee in rents earned by mortgaged property.

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"The rule we adopt . . . looks to state law to define the security interest of the mortgagee." 59 L. Ed. 2d at 141-43.

ness Administration) itself enters into an individually-negotiated loan with a private party, and the federal agency both is equipped to make loans in diverse localities and is either aware of or chargeable with the knowledge that under state law the contracting party has certain defenses to the enforcement of the contract, federal law will not preempt the state statutes. This, the Court explained, is because where an agency is operating at the local level, and can tailor an obligation to the needs of the borrower, it should do so rather than disturb expectations generated by state law systems. See also, *United States v. Kimbell Foods, Inc.*, ___ U.S. ___, 99 S. Ct. 1448, 59 L. Ed. 2d 711 (1979) (held *inter alia*, that absent a Congressional directive to the contrary, the relative priority of private liens and consensual liens on personal property arising from the SBA and FHA government lending programs was to be determined by state law).

The case at bar presents an even stronger argument for concluding that federal law has not preempted the field. Unlike the situation in *Yazell*, no concern exists here for protection of the federal fisc, since federal associations are privately-owned. Protection of the federal associations' interest in their security is already provided by local law. Thus, as stressed in *Yazell*, no reason exists for federal law to invade an area of local concern, *i.e.*, debtor protection, for the benefit of a private party. See also, *Bank of America v. Parnell*, 352 U.S. 29 (1959).

Collateral behavior of the FHLBB, (whose three members direct the operations of the Federal Home Loan Mortgage Corporation (FHLMC)) indicates that it, like the Small Business Administration, is equipped to deal with the variety of state laws on transfers of title and debtor obligations. FHLMC has promulgated a series of fifty uniform mortgage instruments to be used by federal associations and other lending institutions in order that mortgage instruments, when sold in the federally-regulated secondary mortgage market thru FHLMC, will have a standard for-

mat. Each of the fifty versions contains both uniform and non-uniform provisions. The Georgia instrument, for example, contains 17 uniform provisions making the parties' choice of law that of the jurisdiction where the property is located (Paragraph 15) while the latter non-uniform provisions track Georgia law as to nonjudicial foreclosure, note and other Georgia related matters, i.e., Paragraph 25 states: "This conveyance is to be construed under the existing laws of the State of Georgia as a deed passing title, and not as a mortgage, and is intended to secure the payment of all sums secured hereby." This form is precisely the document used in at least one of the cases at bar, with the non-uniform covenants adapted to utilize California law.

In the face of fifty different "uniform" mortgage instruments, it makes no sense whatsoever to have one portion of the contract governed exclusively by federal law while the rest of the contract is governed by state law. The policy of providing assistance to residential mortgagors is not served by presenting a legal obstacle course through the state and federal courts.

Considerable doubt exists whether Congress, even if it so intended, could regulate real property transactions in which the government has no interest. See, e.g., *National League of Cities v. Usery*, 426 U.S. 833 (1976). Under Appellant's theory, the Board is not restricted in any way in determining the extent to which state real property and mortgage law governs federal associations.

Appellants could, therefore, argue that the Board could legally authorize federal savings and loan associations to include in their mortgages a provision allowing them to seek a personal deficiency judgment against a mortgagor even though California Law is quite specific in its confirmation statutes. Likewise, Georgia's statutes limit such action, i.e., *Ga. Code Ann.*, Section 67-1503 et seq. and other states control this subject also, i.e. (Section 702.06, Florida Stat-

utes, expressly prohibits the obtaining of a deficiency where the mortgage is a purchase money mortgage).

Such alleged unlimited authority certainly was not intended by Congress and would result in the destruction of our federal system where the federal and state governments work together in a symbiotic relationship. Assuming Congress, despite the Tenth Amendment, could validly enact uniform federal laws on real property security, it has not done so — (just as it has not adopted the Uniform Commercial Code as a set of federal laws governing personal property).

At least one Georgia jurist has addressed the question of preemption and federal authority when addressing the subject of due-on-sale clauses.[6] Neither California's alienation

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[6] On the subject of federal preemption, Clayton County Superior Court Judge, Joe Crumbley, in the unreported case of *Mitchell v. Georgia Federal Savings & Loan Association (#18779)* (1981) said:

"The question is, has the United States Government (thru the Federal Home Loan Bank Board) so preempted the field that a Federal Savings and Loan Association can successfully maintain that its right to consent to the transfer of property gives it the right to adjust the interest rate on the loan where the contract does not so provide or to determine what the adjusted interest rate should be or to determine whether or not to exercise that option?

"As I see the public policy of Georgia, the old law became unworkable. There was or needed to be some statement of rights that would temper the old cases which said that restraint upon alienation of property is void. The Legislature of the State of Georgia, set out in Ga. Laws 1979, p. 345 (*Ga. Code Ann.*, Section 67-3002) the outer limits of reasonableness. Whether or not they are correct in the amount by which the interest rate may be increased or the intervals in which it may be increased or the events which may trigger an increase are matters that are subject to amendment at least annually; following public hearings and de-

statute (*Civil Code*, Sec. 711), the *Wellenkamp* decision, or Georgia's assumption statute (*Ga. Code Ann.*, Sec. 67-3002), conflict with the FHLBB Regulation, nor diminish it in any way, but merely set "outer limits of reasonableness" on what is otherwise a regulation without limitation. They all stand in the same arena without conflict.

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bate on the floor of the House and Senate. While our state law may not yet be complete, it is far more nearly complete than the body of Federal law cited to this Court. The law of Georgia up until at least 1951 (See, *Alderman v. Crenshaw* 84 Ga. App. 344 (1951)) which declared such things as this Fifth Covenant to be void, has been changed in a concrete, detailed manner by the passage of Ga. Laws 1979, p. 345 (*Ga. Code Ann.*, Section 67-3002).

"Georgia Laws of 1979, p. 345 (*Ga. Code Ann.*, Section 67-3002) are consistent with the purposes of the federal scheme of home loan regulation by reasonably limiting the circumstances under which due-on-sale clauses can be exercised, provides relief to home owners and buyers, discourages unjustified mortgage foreclosures, and embodies the fair local practices which are supposed to guide the Federal Home Loan Bank Board's regulation of federal associations, all in keeping with the purposes of the Home Owners Loan Act of 1933. See 12 U.S.C., Section 1464(a).

"If this Court were to adopt Georgia Federal's argument that local laws do not apply to it, then this Court would have to accept the proposition that merely because Georgia Federal had been granted a federal charter at a given location, and the local zoning laws permitted only residential usage of the property, that Georgia Federal could construct a 15 story edifice thereon and carry on its commercial activity there. Or, on the other hand, before the Congress preempted state usury laws by P.L. 96-161, that simply because Georgia Federal had a federal charter granted by the Federal Home Loan Bank Board that it could charge a home buyer any interest rate it choose in contravention of Georgia's usury statutes. The Court rejects this reasoning."

B. WHEN SUCH IMPORTANT STATE CONTROLLED SUBJECTS AS RESTRAINTS ON ALIENATION OR USURY ARE TO BE FEDERALLY PREEMPTED, CONGRESS ITSELF SHOULD SPEAK AS IT DID IN ENACTING THE "DEPOSITORY INSTITUTIONS DEREGULATION ACT OF 1980."

On December 28, 1979, Congress enacted a Temporary Federal Usury Preemption Statute and enacted a Permanent Statute on the same subject substantially in the same form on March 31, 1980 (P.L. 96-161 and 96-221). It was the announced purpose of the Act to preempt State Constitutions and State Statutes in the area of usury. The Congress left doubt in no one's mind of its intent and purpose. It spoke loud and clear on the subject and with a stroke of the pen, preempted years and years of state control in this area. (The Congress did, however, permit states to reenact usury statutes by direct action on their part within three years of the Act.)

What is the writer's purpose in bringing up the subject of the "Depository Institutions Deregulation Act? Just this! When the Congress intends that there be preemption, it does not leave doubt in the minds of the American people!! It expresses itself loud and clear. Likewise when Congress authorizes a Federal Agency (which only it can create) to preempt a field, that authorization is also given loud and clear.[7]

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[7] The Joint Explanatory Statement of the Committee of Conference stating part of the legislative intent for the Usury Preemption Statute states at page 86, 96th Congress, 2d Session, House of Representatives Report No. 96-842:

"The Senate amendment requires Federal financial institution regulatory agencies to insure that their regulations are needed.

The FHLBB itself recognizes that perhaps it indeed has not preempted state law in the area of due-on-sale. This is apparent in that the FHLBB has requested Congress to pass S. 1720, which, if passed in its present form, would purport to accomplish preemption, although it may contravene the Tenth Amendment.

The FHLBB adoption of the Regulation at best was ambiguous and misleading. The FHLBB used the phrase "A Federal Association 'continues' to have the power to include", 12 C.F.R. 545.6-11(1975), when indeed the FHLBB had never before the Regulation, mentioned a due-on-sale clause, much less authorized its use in a mortgage contract.[8] The FHLBB, therefore, has not complied with the standards enunciated in *Free v. Bland*, 369 U.S. 663 (1962) and *United States v. Shimer* 367 U.S. 374 (1961), nor has the FHLBB complied with the Administrative Procedures Act, 5 U.S.C. Sub Sec. 500 et seq. This Court in *Chrysler Corporation v. Brown* 441 U.S. 281, 99 S. Ct. 1705, 60 L.Ed. 2d (1979), would not permit enforcement of a Regulation improperly adopted, and the Court should do the same in this case.

1. CONGRESS LACKS AUTHORITY TO DELEGATE ITS LEGISLATIVE RESPONSIBILITY.

The Board's Regulation, 12 CFR Sec. 545.8-3(f) and (g), as it purports to authorize Federally chartered associations to include due-on-sale provisions, is clearly an attempt to

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[8] Schott Opinion: *Schott v. Mission Fed. S & L Assn.*, Civil Action No. 75-366-WMB (C.D. Cal. 1975):

"In the situation at issue herein, the Board does not have a regulation dealing specifically and exclusively with "due-on-sale" clauses in the loan instruments of Federal savings and loan associations."

pass a law, not a regulation. Under the United States Constitution only Congress can pass Federal laws. *U.S. Const. Art. I.* There is no Constitutional provision for the delegation of this authority to anyone. HOLA in no way authorizes the Board to pass Regulations that are in fact laws attempting to govern real property law, contract law and mortgage and security interest law. For this reason the Boards' Regulation as it purports to deal with due-on-sale should be declared null and void.

Congress, in addressing mortgage lending practices, has repeatedly advised FHLBB that it will not tolerate Regulations by the Board which permit Alternative Mortgage Instruments which do not adequately protect consumers.[9] To this end, several Alternative Mortgage Instruments have been developed, such as Renegotiable Rate Mortgages (RRM's) where the rate is renegotiated on intervals of three to five years, yet there is a maximum increase established for the life of the loan and on each renegotiation period. Furthermore, there are provisions for the interest rate to decrease if the appropriate indexes to which the rate is tied indicates a reduction is in order. This is not so with the due-on-sale. Once that rate is established, there is no provision for a reduction. Such was not the intent of Congress.

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[9] Congressional Record — House (H 525), February 8, 1979; 96th Congress, First Session (S. 218); Congressional Record — Senate (S 646) January 25, 1979; and more importantly Congressional Record — Senate (S 2167) February 3, 1977; S. Con. Res. 9 (3) "The FHLBB shall take into account appropriate consumer safeguards, the existing competitive environment and the needs of Federal Savings and Loan Associations in adopting any regulations which allow Federal Savings and Loan Associations to offer a wide variety of flexible mortgage instruments to the public."

C. THE FHLBB CAN NOT PREEMPT THE EQUITABLE POWER OF A STATE COURT TO REFUSE TO ENFORCE DUE-ON-SALE CLAUSES.

Ten years ago Justice Hugo Black wrote eloquently of the proper relationship between the Federal Government and the several States, describing the concept of "comity" in terms reflecting principles of federalism.[10]

The system of federalizm adopted by the FRAMERS recognizes the States are "indestructible" *Texas v. White*, 74 U.S., (7 Wall) 700, 725 (1868), and they are independent "within their own proper spheres," *Lane County v. Oregon*, 74 U.S. (7 Wall) 71, 76 (1868). The Federal and State Governments may neither destroy each other "nor curtail in

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[10] ". . . a proper respect for State functions, a recognition of the fact that the entire country is made up of a Union of separate State Governments, and the continuance of the belief that the National Government will fair best if the States and their institutions are left free to perform their separate functions in their separate ways . . . one familiar with the profound debates that ushered the Federal Constitution into existence is bound to respect those who remain loyal to the ideals and dream of 'our federalism.' This concept does not mean blind deference to 'States' rights' anymore than it means centralization of control over every important issue in our National Government and its Courts. The FRAMERS rejected both these courses. What the concept does represent is a system in which there is sensitivity to the legitimate interest of both State and National Governments and in which the National Government, anxious though it may be to vindicate and protect Federal rights and Federal interest, always endeavors to do so in ways that will not unduly interfere with the legitimate activities of the States. It should never be forgotten that this slogan, 'our federalism,' born in the early struggling days of our Union of States, occupies a highly important place in our Nation's History and its future." *Younger v. Harris*, 401 U.S. 37, 44-45 (1971).

any substantial manner the exercise of each others powers." *Metcalf & Eddy v. Mitchell,* 269 U.S. 514, 523 (1926).

The need to respect the States and their place in the Federal system is ultimately required by necessary respect for the freedom of the people. The issue of State sovereignty involves more than a struggle for power between competing local and national authorities. State sovereignty must be understood in light of the struggle 200 years ago by men and women desiring to be free, to have self-government and to exercise self-determination. State sovereignty is the result of a grant of power by the people and attains its life from them. It is from the people that the States receive their ligitimacy and their sovereign characteristic. "State sovereignty in reality is, as de Tocqueville expressed, "People sovereignty." *Lay, States Rights: The Emergence of New Judicial Perspective,* 22 S.D.L. Rev. 1, 14 (1977). Thus, interference with the sovereignty of the States in the areas of property and contract law, amounts to interference with the sovereignty and the rights of the people of the States.

At stake in this case are the freedoms and rights of our citizens to have redress in State Courts of equity, not just an abstract struggle for power between governmental entities. The Federal system that gave life and breath to the ideals and dreams of the FRAMER in 1789 continues to protect and nurture our liberties as citizens. The Constitution must be protected from this unwarranted national government control in the area of real property and contract law.

T. A. Jacoway, in his definitive treatise on the role of Equity in regard to enforcement of "due-on-sale" clauses, states: "Whenever a literal application of the law works an unconscionable hardship, equity often relieves the oppressed and, thereby adds humanity, flexibility and justice to what would, if left to the impersonal operation of the law, be an intolerable result," *Ark. Law Review,* Vol. 26, 488

et seq. What happens to the traditional role of Equity in State Courts in the event Congress either by its own declaration, or the declaration of one of its regulatory agencies, preempts State Law as relates to defaults in mortgages and foreclosures eventuating therefrom? To understand what preemption would do to state equity jurisdiction, one must contemplate the responsibility, if any, of equity. What is the role of equity as relates to the enforcement of a "due-on-sale" clause? Jacoway's treatise on the relationship of Equity and "due-on-sale" clauses reveals an answer.

When State Courts of Equity give relief to the oppressed against the impersonal operation of the law, Equity necessarily acts in derogation of the law and may unsettle the security of legal predictability. It is irrefutable, however, that if Equity is to have any purposeful existence outside the Law, it must occasionally offend legal principles, namely, the sanctity of contract (see the introductory of J. N. Pomeroy Equity Jurisprudence, Vol. 1 and 1 Pomeroy, Equity Jurisprudence, Section 50 and 2 Pomeroy, Equity Jurisprudence, Section 427). It has even been said that there is no finer example of the triumph of equitable principles over the injustice of legal dogma than in the protections afforded the mortgagor's equitable estate (1 J. N. Pomeroy Equity Jurisprudence, Sec. 51 and 2 Pomeroy, Equity Jurisprudence Sec. 382; see also *Gale v. York Center Community Cooperative, Inc.*, 21 Ill. 2d 86, 171 N.E. 2d 30). To declare a familiar adage, "Equity follows the law but not slavishly."

State Courts of Equity (or Chancery) have always been the final arbiter of foreclosure suits and the great protector of the rights of mortgagors.

The equitable principles enunciated by Courts of Equity in foreclosure suits are:

a. Equity will not countenance clogs upon the mortgagor's equity of redemption (see *Coursey v. Fairchild*,

436 P. 2d 35; *Hill v. Day*, 231 Ark. 550, 331 S. W. 2d 38 and generally 55 Am. Jr. 2d mortgages Section 514).

b. Equity will invalidate restraints upon the free availability of property (numerous cases and citations, infra.).

c. Equity will strictly construe ambigious mortgage clauses against drafter-lenders. (see *Planter's National Bank of Mea v. Townsend*, 197 Ark. 267, 123 S. W. 2d 527; also see *Tahoe National Bank v. Phillips*, 92 Cal. Rptr. 704, 480 P. 2d 320).

Jacoway relates (Ark. Law Rev., Vol. 26, 485) that State Courts of Equity traditionally have considered the essential rights of ownership of property and that any unreasonable restraint upon the availability of property is invalid. This theory had its genesis in economic considerations, namely, public policy required that property flow freely in the stream of commerce. Even though reasonable restraints are now tolerated, Equity is still noticeably reluctant to subordinate the historically sanctified rights of mortgagors to those of mortgagees. There are two primary reasons Equity has resisted erosion of the doctrine against restraints where mortgagors were involved:

(1) The right to sell, transfer or encumber is the very essence of real property rights; and

(2) Usually, mortgagors were at the mercy of large lending institutions when real estate mortgage money is bargained for; (Ark. Law Rev. Vol. 26: 485)

Even when equitable principles are not directly involved the "conscience" of the Court is. Mortgagors have traditionally been able to go to State Courts asking for an injunction against a foreclosing mortgagee for protection against unconscionable and harsh foreclosures. Equity will not condone injustice by enforcing "unreasonable", "harsh", "burdensome", or "unconscionable" clauses. (See E. G.

Blomgren v. Tinton, 763 Corp., 18 A.D. 2d 979, 238 N.Y.S. 2d 435). Is the "conscience" of State Courts to be supplanted by regulations of the Federal Home Loan Bank Board in matters having to do with foreclosure under State Laws? If so, a regulation of the Federal Home Loan Bank Board could compel a State Court of Equity to permit the foreclosure of a borrower's equity and at the same time command that State Court of Equity divorce itself from any balancing of the equities.

The underlying, if not obvious, purpose of the "due-on-sale" clause, more aptly termed "escalation clause," is to afford the lender the opportunity to renegotiate the lending rate with the would be purchaser. If such a right were bargained for in terms that were disclosed to the borrower at the time the loan was applied for and the borrower was told that there would be a departure from the time honored custom of selling property subject to the loan, many State Courts of Equity would allow its enforcement. If the security would be jeopardized by substitution of the mortgagor, no Court of Equity would require the lender to accept a new mortgagor.

Until recent years, the "due-on-sale" clause camouflaged itself under the avowed purpose of minimizing special risks which face the lender when there is a subsequent transfer of the property (although some contend that the "due-on-sale" clause was originally used by lenders to protect their security interest) . . . most authorities agree that it was conceived primarily to combat the rising interest rates in the 1960's.[11]

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[11] Federal National Mortgage Association, public meeting on conventional mortgage forms, S. Doc. No. 92-21, 92d Cong., 1st Sess. 147 (1971) Statement of Haydon M. Calvert, Sr., Vice-President, Prudential Federal Savings & Loan Association, Salt Lake City, Utah).

To some degree a lender's losses will always be passed on to the consumer, but this consequence alone cannot justify favoring the lender. (Univ. of Miami L. Rev. 33, 732).

It may be true that Federal Savings & Loan Institutions have been victimized by the ravages of inflation and several Courts employing equitable principles have suggested that a clear and unambigious bargained for clause in a real estate contract which allowed acceleration upon sale, might be permissible to maintain interest rates; however, the Courts objected to the underhanded way the lenders tried to achieve this result. (See *First S. Federal Savings & Loan Association v. Britton*, 345 So. 2d 300, 303; *Nichols v Ann Arbor Federal Savings & Loan Association v. Fetter*, 564 p. 2d 1013, 1019; *Bellingham First Federal Savings & Loan Association v. Garrison*, 87 Wash. 2d 437, 440, 553 P. 2d 1090, 1091.

California's Alienation Statute (Civil Code Sec. 711) as construed by the California Supreme Court in *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978) assures a mortgagor the right of a court of equity scrutinizing a foreclosure before the home owner loses his equity by such an action.

Unless centuries of settled law is now to be unsettled, it must go unchallenged that mortgagee control over the secured property is justified solely by the need for protection of the security that stands behind the loan. If a different criteria is desirable to correlate equitable consideration with the exigencies of modern business, the Court should so stipulate. At least, a rate control clause should be a directly bargained for term. (see Ark. Law Rev. Vol. 26; 501). State Courts of Equity can decide whether or not a rate control clause is indeed actually bargained for. The greatest potential danger, however, is disguised by the seeming innocuity of the "due on sale" clause. If the lender has unrestrained power to deny consent to any sale or transfer, the lender has virtual life and death control of the property. By an

upward adjustment in the lending rate, coupled with an exorbitant transfer fee or a large prepayment penalty if the loan is prepaid, the borrower can be locked in. Indeed, the lender not only has the right to choose his debtor but the more far reaching power to determine who will or who will not own the property. The exercise of such control is the logical consequence of automatically enforcing "due on sale" clauses.

As intimated in *Tahoe National Bank,* (supra), when Equity entertains the particular validity of "due on sale" or "encumbrance" clause, it should be mindful that it may well have an adhesion contract situation by the tail. Indeed, it is this enormous discrepancy in the balance of bargaining power that requires of Equity its closest attention, not only to the particular application of the clause, but also to the possible ramifications of any "carte blanche" validation (also see Ark. Law Rev. Vol. 26:485).

Since an increase in the lending rate was not reasonably to be expected by the mortgagor in the vast majority of cases, at least between the years 1972 and 1978, as a precondition to a valid assumption, it is fundamentally unfair for a Court to countenance such a precondition. Within the last two years the public consciousness of "due on sale" clauses in loan documents has been raised and therefore it is less likely that very recent mortgators have been exploited, however, the right to sell or transfer property is the core of the mortgagor's ownership interest, and the Court should not constructually confiscate the right unless it is intentionally bargained away by the mortgagor and such is permissible in the public policy of the particular State where the property is located.

In circumspection, therefore, State Courts of Equity must not be dethroned from balancing the equities of each particular case. If the lender wants to extend control over the secured property so that the lending rate can be renegotiated, a clear statement of such intent should be manifest

and such control should be fairly exercised. Otherwise, lenders should be held to traditional notions of what circumstance is justified by denial of consent; mainly, possession or assumptions which jeopardize the lender's security interest. (Ark. Law Rev. Vol. 26:485)

Economic travail of the thrift industry does not justify crucifying the "locked in" mortgagor on a cross of economic expediency!

D. THROUGH ITS PROTECTION OF STATE SOVEREIGNTY, THE TENTH AMENDMENT PROHIBITS CONGRESSIONAL REGULATORY MECHANISMS SUCH AS THE FHLBB REGULATION.

Even if the FHLBB Regulation is seen as based upon an otherwise proper assertion, it transgresses the barrier of State sovereignty and thus represents a violation of the Tenth Amendment. See *National League of Cities v. Usery*, 426 U.S. at 843 N. 14. This Court's *Usery* decision marked a reaffirmation of the continuing vitality of the Tenth Amendment and the system of federalism it recognizes. In striking down a congressional action regulating conditions of employment within the state and local governments, this Court concluded that "the dispositive factor" in the unconstitutional exercise of congressional authority was the attempt to regulate actions "by the States in their capacity as sovereign governments." *Usery*, 426 U.S. at 852.

The FHLBB due-on-sale regulation undermines the most traditional attribute or function of State Government i.e., power to govern in those areas not otherwise granted in the U.S. Constitution. It interferes with the independence of the States to regulate, to initiate policy, to adjudicate, to legislate and through its Court system to take into consideration the balancing of equities as to any particular situa-

tion. If this Court reverses the California Court of Appeal, State Courts would be unable to consider whether or not the conduct of a foreclosing lender was reasonable or unreasonable. Legislatures would be unable to correct what they see as abuses of contractural powers. By threatening to displace such functions, the FHLBB Regulation is unconstitutional.

E. SOCIAL AND ECONOMIC CONSEQUENCES OF UNBRIDLED VALIDATION OF DUE-ON-SALE CLAUSES.

Many home owners who wish to sell their homes do so in order to buy a new one. When they are unable to sell, they in turn are unable to purchase a new one, thereby adversely impacting new home construction. According to the Chicago Title Insurance Company's survey dated Jan. 8, 1982, "Repeat buyers made up 60.6% of the 1981 new home market, down from 67.1% in 1980, and the Title Company's survey of Feb. 19, 1982 shows that 46.2% repeat buyers of new homes in 1981 generated all of the down payment for their new home from the sale of a previous home.

Due-on-sale clauses have restrained many existing home owners from selling, who otherwise would be likely candidates for new housing. Revitalization of the new housing industry is dependent upon revitalization of the resale housing industry. This country could possibly see a new housing boom with the removal of due-on-sale restraints.

Eighteen states presently have due-on-sale restrictions. Statistics show no lower rate of new housing starts in those areas. The distressed new housing market is felt throughout our country, and it will be helped only when interest rates are lowered to rates purchasers are willing to pay and investors feel confident in long term investments. Unbridled validation of due-on-sale clauses resulting in escalation of in-

terest rates add to the expense of owning a home, and thus discourage home sales.

CONCLUSION

To allow the Federal Home Loan Bank Board to preempt State public policy, something never envisioned in HOLA, could embolden them to apply this regulatory scheme so that local zoning ordinances, building codes or sanitary regulations might be endangered. The end result can be imagined easily. A hypothetical situation may be a foreclosed single family subdivision where the Federal Savings and Loan Association could make a windfall by simply converting it to multi-family or commercial use in derogation to local zoning ordinances. When State Governments are left with memories instead of functions, there will be no federal system.

The gate must be closed to the forbidden path the Federal Home Loan Bank Board has chosen. The National Government must not be allowed to "devour the essentials of State sovereignty . . . ." *Maryland v. Wirtz*, 392 U.S. 183, 205 (1968). The Georgia Association of Realtors® urges the Court to affirm the judgment of the Court below.

Respectfully submitted,

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Amicus Brief

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No. 81-750

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, INC., ET AL.,

APPELLANTS

v

REGINALD D. de la CUESTA, ET AL.,

APPELLEES

On Appeal From The California Court of Appeal
For The Fourth Appellate District

AMICI CURIAE BRIEF OF MICHIGAN, ARKANSAS, ARIZONA, COLORADO, CONNECTICUT, ILLINOIS, INDIANA, KANSAS, MAINE, MINNESOTA, MISSISSIPPI, MONTANA, NEW HAMPSHIRE, NEW MEXICO, NORTH CAROLINA, NORTH DAKOTA, OHIO, OREGON, SOUTH CAROLINA, VERMONT, WASHINGTON AND WISCONSIN

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QUESTION PRESENTED

I.

WHETHER A STATE LAW PROHIBITING UNREASONABLE "RESTRAINTS ON ALIENATION" OF PROPERTY, AS APPLIED TO A "DUE-ON-SALE" CLAUSE IN A MORTGAGE WRITTEN BY A FEDERAL SAVINGS AND LOAN ASSOCIATION, HAS BEEN PREEMPTED BY THE HOMEOWNERS LOAN ACT OF 1933, 12 USC 1416 et seq, AND REGULATIONS PROMULGATED THEREUNDER.

No. 81-750

IN THE
SUPREME COURT OF THE UNITED STATES
October Term, 1981

FIDELITY FEDERAL SAVINGS AND
LOAN ASSOCIATION, INC., ET AL.,
APPELLANTS
v
REGINALD D. de la CUESTA, ET AL.,
APPELLEES

On Appeal From The California Court of Appeal
For The Fourth Appellate District

AMICI CURIAE
BRIEF OF THE
STATE OF MICHIGAN, ET AL

I.

Interest of the Amici Curiae

The *amici* States file this brief in support of the appellee-homeowners requesting this Court to affirm the decision of the California Court of Appeals in *de la Cuesta, et al* v *Fidelity Federal Savings and Loan Association, et al*, 121 Cal App 3d 328, 175 Cal Rptr 467 (1981). The immediate issue concerns the ability of the Federal Home Loan Bank Board to promulgate rules compelling State enforcement of the due-on-sale clause. The underlying issue which is germane to the *amici* involves the Board's usurpation of non-delegated congressional preemption powers to effect the Board's policies

and thereby infringe upon the rights reserved to the States under the 10th Amendment to the United States Constitution.[1]

Through its action, the Bank Board has intentionally deprived homeowners in these States of their right to freely buy and sell property and has further denied them the right to raise certain equitable defenses in the State foreclosure proceedings. Moreover, the Board has denied State courts the equitable power to refuse enforcement of the "due-on-sale"

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[1] The Michigan law barring enforcement of the due-on-sale clause, except where the lender demonstrates security impairment, is based on the common-law bar on restraints against alienation. See *Nichols* v *Ann Arbor Federal Savings & Loan Association*, 73 Mich App 163; 250 NW2d 804 (1977). Many other states agree with Michigan law on due-on-sale provisions. *Patton* v *First Federal Savings & Loan Ass'n*, 118 Ariz 473; 578 P2d 152 (1978); *Baltimore Life Insurance Co* v *Harn*, 15 Ariz App 78; 486 P2d 190 (1971), *for review denied*, 108 Ariz 192; 494 P2d 1322 (1974); *Tucker* v *Pulaski Federal Savings & Loan Ass'n*, 252 Ark 849; 481 SW2d 725 (1972); *Wellenkamp* v *Bank of America*, 21 Cal 3d 943; 148 Cal Rptr 379; 582 P2d 970 (1978); *First Federal Savings & Loan Ass'n* v *Lockwood*, 385 So 2d 156, 159 (Fla Dist Ct App 1980); *Clark* v *Lachenmeier*, 237 So 2d 583 (Fla Dist Ct App 1970); *Sanders* v *Hicks*, 317 So 2d 61 (Miss 1975); *First Commercial Title* v *Holmes*, 92 Nev 363; 550 P2d 1271 (1976); *Continental Federal Savings & Loan Ass'n* v *Fetter*, 564 P2d 1013 (Okla 1977); *Bellingham First Federal Savings & Loan Ass'n* v *Garrison*, 87 Wash 2d 437; 553 P2d 1090 (1976). Colo Rev Stat §38-30-165. *Cf. Tierce* v *APC Co*, 382 So 2d 485, 487 (Ala 1980) (although increase of interest rate is a valid reason for exercising a due-on-sale clause in a commercial mortgage, clause is not automatically enforceable; enforcement can be refused where result would be inequitable and unjust); *Silver* v *Rochester Savings Bank*, 73 AD2d 81, 424 NYS 2d 945 (1980) (mortgage requiring that lender's consent to transfer of title may not be unreasonably withheld; lender may not condition consent on increase in interest rate); *Gibralter Finance Corp* v *Rouse*, 145 Ore 89; 25 P2d 559 (1933) (lender may not accelerate for technical

clause based on the common law doctrine barring restraints on the alienation of real property.

The Bank Board has departed from its traditional role of regulating the internal activities of federally chartered savings and loan associations. Unsatisfied with supervising capital and reserve requirements, and approving branch, merger, and conversion applications, the Board has embarked on a program to override state statutes and common law doctrines, which the Bank Board believes impede the ability of federal savings and loan associations to maximize earnings. Devoid of any congressional authorization, it has taken the first step toward a national system of mortgage and contract law.

The State of Michigan, as well as other *amici*, is facing an economic crisis. Unemployment in Michigan exceeds 16%. Homeowner mortgage defaults are rising to depression rates. Nonetheless, the Bank Board is acting to protect federal lending institutions at the expense of homeowners while disregarding state statutes and common law. Admittedly, the current high interest rates squeeze the profit margins of many lenders, but they concomitantly prevent the jobless homeowner from selling his or her property in order to move to find work. The homeowner's inability to market the property because the due-on-sale clause prevents offering a second mortgage, a land contract, or an assumption agreement, places the homeowner in the position of one who cannot make his payments and cannot rescue his investment by selling the equity in his home.

These *amici* are concerned that the unrestrained assumption of power by the Bank Board will erode other areas cur-

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default when not actually injured); Holiday Acres No. 3 v Minneapolis, 308 NW2d 471 (Minn., 1981) (Bank board regulations do not preempt state law); State, *ex rel* Bingaman v Valley Savings & Loan Ass'n, 636 P2d 279 (New Mex., 1981).

rently reserved to the States. Under the pretense of protecting the "best interests" of federal savings and loan associations, the Board may decide to abrogate mortgagor redemption rights, state foreclosure proceedings, laws establishing lien priorities, and ultimately the elements of a contract and the competency of the parties. While any exercise of the ultimate preemptive power is a challenge to the States, it becomes unacceptable when unilaterally exercised by a federal administrative agency without any indication of congressional authority, which the Constitution of these United States requires. No consideration has been given by the Board to opposing social concerns and traditional legal and equitable principles which militate against enforcement of contract provisions such as the due-on-sale clause. This Court is entrusted with the duty to oversee the constitutional balance between state-federal government. The bureaucratic federalism exhibited here strikes at the heart of this Court's respect for the reserved rights of the States and constitutes a threat to all powers exercised by the States if the executive branch of the federal government may unilaterally preempt State laws and judicial decisions of long standing.

The most serious ramification of a decision reversing the California Court of Appeals will be the further erosion of the 10th Amendment of the United States Constitution. What limited rights the States have left will be subject to further usurpation by the Bank Board and other federal agencies which presently possess broad powers to regulate certain entities and endeavors. For centuries, real estate transactions have been regulated in almost all aspects by the laws of the several States. Fifty years after its inception, the Bank Board has decided to encroach upon this field by dictating to the States and their courts how they must enforce a contract provision deemed in these States to be a restraint on alienation.

II.

Summary of Argument

This brief will focus on the fact that preemption must eminate from an act of Congress and that the congressional intent to preempt must be clearly and unambiguously expressed in the governing statute. An examination of the federal Homeowners Loan Act of 1933 (HOLA), 12 USC § 1461 *et seq*, 48 Stat 128 *et seq* (June 13, 1933), fails to disclose even a hint of any congressional intention to displace State contract and mortgage laws. Furthermore, a perusal of HOLA and other federal laws evidences a clear and consistent congressional respect for State mortgage regulation and further suggests that the authority of the Bank Board to examine such state laws does not extend to the right to preempt the field.

III.

Argument

A. AN EXAMINATION OF THE GROUNDRULES SURROUNDING THE PREEMPTION ANALYSIS

The allegedly preemptive federal law relied upon by appellants is the federal Homeowners Loan Act of 1933 (HOLA), 12 USC § 1461 *et seq*, 48 Stat 128 *et seq* (June 13, 1933). The regulations dealing with due-on-sale clauses, recently promulgated by the Federal Home Loan Bank Board, 12 CFR § 545.8-3(f) and 12 CFR § 556.9, were purportedly authorized by HOLA, *supra*, which was enacted in the heart of the depression to save homeowners from the then current eco-

nomic crisis. Since *McCulloch* v *Maryland*, 17 US (4 Wheat) 316 (1819), this Court has consistently recognized the significance of basing any finding of preemption upon a clear congressional intent to preempt. In *Rice* v *Santa Fe Elevator Corp*, 331 US 218, 230 (1946), this Court held that the issue "in each case is what the purpose of Congress was." Similarly, in *Retail Clerks* v *Schermerhorn*, 375 US 96, 103 (1963), this Court held that the "purpose of Congress is the ultimate touchstone" in determining whether a particular federal statute preempts State law.

Another guiding principle is the notion that a presumption against preemption always exists. *Chicago & Northwest Transportation Co* v *Kilo Brick & Tile Co*, ... US ....; 101 S Ct 1124; 67 L Ed 2d 258 (1981). One rationale behind this negative presumption is that Congress can always change a finding of no preemption by enacting future legislation. An erroneous determination of preemption, however, would leave the States powerless to remove the effect of the court's decision.[2] *Penn Dairies, Inc* v *Milk Control Commission*, 318 US 261, 275 (1943).

The presumption against preemption is particularly strong in an area "traditionally occupied by the states." *Jones* v *Rath Packing*, 430 US 519, 525 (1977). In such a case, "we start with the assumption that the historic police powers of the States were not to be superceded by the Federal Act unless that was the clear and manifest purpose of Congress." *Ray* v *Atlantic Richfield Co*, 435 US 151, 157 (1978). To find a "complete ouster of state power", *DeCanas* v *Bica*, 424 US 351, 357 (1976), as the Bank Board here urges, there must be

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[2]

Several bills are pending which specifically provide that the "due-on-sale" clause is enforceable in all 50 states. See HR 1703, § 301 (1981) and S. 1720.

"an unambiguous congressional mandate to that effect." *Florida Lime and Avocado Growers, Inc* v *Paul,* 373 US 132, 147 (1963).

There can be little question that the area of real property law has traditionally been the sole domain of state law. *Butner* v *United States,* 440 US 48, 55-56 (1979) ("Property interests are created and defined by state law. . . . The justification for application of state law are not limited to ownership interests; they apply with equal force to security interests. . . . The rule we adopt . . . looks to state law to define the security interest of the mortgagee. . . ."); *Davies Warehouse Co* v *Bowles,* 321 US 144, 155 (1944) ("The great body of law in this country which controls acquisition, transmission, and transfer of property, and defines the right of its owners in relation to the state or to private parties, is found in the statutes and decisions of the state."); *Hoopeston Canning Co* v *Cullen,* 318 US 313, 318 (1943) (State law "is the source of law for . . . mortgages, and for many other legal principles affecting property interest."); and *Aronson* v *Quick Point Pencil Co,* 440 US 257, 262 (1979) ("Commercial agreements traditionally are the domain of state law.")

That the 10th Amendment reserves to the States the right to control the transfer of real property was axiomatically stated by this Court over a century ago in *United States* v *Fox,* 94 US 315, 320-321 (1876), as follows:

> "The power of the State to regulate the tenure of real property within her limits, and the modes of its acquisition and transfer, and the rules of its descent, and the extent to which a testamentary disposition of it may be exercised by its owners, is undoubted. It is an established principle of law, everywhere recognized, arising from the necessity of the case, that the disposition of immovable

> property, whether by deed, descent or any other mode, is exclusively subject to the government within whose jurisdiction the property is situated. *McCormick* v *Sullivant*, 10 Wheat 202. The power of the State in this respect follows from her sovereignty within her limits, as to all matters over which jurisdiction has not been expressly or by necessary implication transferred to the Federal government. The title and modes of disposition of real property with the State, whether *inter vivos* or testamentary are not matters placed under the control of Federal authority. Such control would be foreign to the purposes for which the Federal government was created, and would seriously embarrass the landed interests of the State."

In light of the fact that Congress would have been interfering with a long standing and clearly recognized State right, the intent to allow the Bank Board to preempt state mortgage laws must be patently clear before the Board may exercise that power.

B. AN EXAMINATION OF THE HOMEOWNERS LOAN ACT OF 1933 DOES NOT REVEAL ANY CONGRESSIONAL INTENT TO ALLOW THE BANK BOARD TO PREEMPT STATE MORTGAGE AND CONTRACT LAWS

The stated purpose of HOLA is contained in its preamble, 48 Stat 128 (1933), as follows:

> ". . . to provide emergency relief with respect to home mortgage indebtedness, to refinance home mortgages, to extend relief to the owners of homes occupied by them and who are unable to amortize their debts elsewhere . . ."

Congress sought to accomplish these goals by providing immediate relief to homeowners facing foreclosure by acquiring and refinancing mortgages in default (12 USC § 1463, since repealed) and by providing additional funding for the home mortgage lending industry.

The infusion of mortgage capital was to be accomplished through the federal home loan bank system, which had been established the previous year and which had been patterned after the federal reserve system, as a mechanism to funnel money to member associations. Notwithstanding these accomplishments, Congress still faced a problem which potentially undermined the salutary impact of this legislation. The Home Loan Bank Act had contemplated that savings and loan associations would act as the vehicles through which federal money could reach needy consumers. However, Congress had discovered that large portions of the country were not being serviced by any savings and loan associations. Thus, Representative Luce stated in introducing HOLA:

> "There are in this country 3,072 counties. There are 1,566, almost half, that have no building and loan associations, no mutual savings banks, and no insurance companies and therefore cannot benefit by the provisions of last year's law."
>
> 77 Cong Rec 2480 (April 27, 1933)

In response to the question whether "it is an absolute necessity to form additional savings and loan associations", Representative Goldsborough responded:

> "If a county has no organization or whatever to loan money, the gentleman knows, probably as well or better than I, then it is almost impossible to get money from the bank at this time. It was in this theory that these associations were set up."
>
> 77 Cong Rec 2486 (April 27, 1933)

This intent is repeated in the statements of Senator Bulkley, who introduced the bill in the Senate, 77 Cong Rec 4974, as well as in the statement of Representative Luce, at 77 Cong Rec 2480. No other purpose is stated by a Congressman or committee report, from which an intention to provide a uniform system of land transfer could be claimed.

Moreover, there is no support for the claim that HOLA was enacted in response to a "hodgepodge" of state regulation. (See Bank Board's *amicus* brief, at p 11)[3] Nor is there any suggestion that HOLA was enacted in response to the failings of the existing state operated system or to eliminate any pernicious state practice. Indeed, references in the Congressional Record belie any such suggestion. Senator Bulkley, for example, stated that one reason for eliminating the authority of the home loan banks to make direct loans to consumers was because existing savings and loan associations (which at the time were all state chartered) "have handled the business much more satisfactorily that the home loan bank felt it was possible for the home loan banks to handle it." 77 Cong Rec

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[3]

In lieu of ascertaining congressional expressions to support its theories, the Bank Board relies on statements of partisan commentators. In this case, the "hodgepodge" theory is ascribed to a Mr. T. Marvel. Without denegrating the credentials of the author, it is interesting to note from his biography that Mr. Marvel worked for the Bank Board in 1966 for a year and a half following his graduation from law school. Mr. Marvel's volume is essentially undocumented and his expressed opinions, if not reflective of official board dogma, are distinctly his own. We call this to the Court's attention only because it exemplifies the depths the Board will reach to support its views. Even the most recent "task force" report provided the Court by the Board and summarized in an appendix to its brief reveals a desperate attempt to *post hoc* rationalize its action. The "task force" was created by the Board in the midst of coast-to-coast litigation and was comprised *in toto* of members of the Board's staff and representatives of the savings and loan industry. Not one representative for consumers or for the States was even nominally appointed. Thus, the findings of this "task force" were but a foregone conclusion.

4975. Similarly, Senator Bratton, while noting that existing state chartered associations were not meeting the needs of homeowners, hastened to add:

> "I did not say that in the spirit of criticism. They are not able to do so. Economic conditions make it so."
>
> 77 Cong Rec 4988 (June 5, 1933)

Further analysis discloses that the concept of HOLA was not unprecedented. Congress had permitted the creation of national banks for almost 70 years prior to its enactment and had created 12 regional home loan banks just as it had created 12 regional federal reserve banks. In permitting the chartering of federal savings and loan associations, Congress was simply following the pattern established with respect to national banks. Senator Bulkley supported this view when he stated:

> "The power we propose to give here is quite similar to the discretion given the Comptroller of the Currency with respect to chartering national banks."
>
> 77 Cong Rec 4987 (June 5, 1933)

Similarly, Representative Reilly explained:

> "The home-loan bank bill was designed to serve existing home financing institutions, as the Federal Reserve System at the present time serves its member banks."
>
> 77 Cong Rec 2487 (April 27, 1933)

and:

> "The home loan banking law was intended to serve existing home-financing institutions just the same as the Federal Reserve System served its member banks."
>
> 77 Cong Rec 296 (March 13, 1933)

The one thing that was clear at the time HOLA was enacted was that the contract rights of national banks were governed by State law. This had been conclusively established by this Court in *First National Bank of Louisville* v *Kentucky*, 76 US 353, 362 (1870), as follows:

> "[National banks] are subject to the laws of the State, and are governed in their daily course of business far more by the laws of the State than of the nation. All their contracts are governed and construed by State laws. Their acquisition and transfer of propperty, their right to collect their debts, and their liability to be sued for debts, are all based on State law. It is only when the State law incapacitates the banks from discharging their duties to the government that it becomes unconstitutional."

Thus, it is highly doubtful that in light of Congress' experience with the chartering and regulation of national banks it would have made the Bank Board omnipotent and consequently allow that agency alone to supercede State contract and real property laws without one mention of this power.

The Bank Board's contention that there is a need for national uniformity with respect to the regulation of federally chartered savings and loan associations, particularly in their loan instruments, is perhaps most belied by the testimony of its first chairman at the 1933 congressional hearings considering the HOLA bill.[4] In describing the need for broad

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[4]

Throughout its brief, the Board suggests that one reason to enforce the due-on-sale clause is to protect the integrity of the secondary market. Such a claim is unsupported by the record. The Federal National Mortgage Association ("Fannie Mae"), a federally chartered corporation, is the nation's largest supplier of home mortgage funds, currently owning about two million home mortgages. In recent correspondence, attached as Appendix A, the Association advised that it exercises the clause only

powers within the Bank Board, Mr. William F. Stevenson testified as follows:

> "A good many people think we ought to put all the state regulations, what they ought to do and all that kind of thing, in here. But that is left to regulation by the board, who will put the most expert building and loan authorities on it to provide those regulations, so that the regulations can be varied. In some states you have to deal with them one way and in other states another way, and we want the latitude allowed to fit the regulations of the board and the associations to the state law and the different needs."
>
> Hearings on HOLA, HR 4980, 73rd Congress, 1st Session, 7, (April 20, 1933)

In responding to an inquiry on whether the federal savings and loan associations would comply with pertinent state law, Mr. Stevenson further testified:

> "These associations will be federally chartered and the regulations as to how those things will be done are drawn by the board and put into effect. But they will be very careful I should say. I know I would as a member of

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where permitted by state law. In the fourteen states which do not permit enforcement of the clause, the Association requires a seven year "balloon" provision. The other major secondary mortgage market, the Federal Home Loan Mortgage Corporation, has recently advised that it does not enforce the due-on-sale clause to raise interest rates. (A copy of the pertinent letter is attached as Appendix B). Thus, preemption of state law regarding due-on-sale has never been a factor in the market availability of secondary financing. The use of uniform clauses, such as the due-on-sale, is simply to make the instruments fungible.

> that board be very careful in authorizing them to do things that they were not authorized to do under state law. I do not think that would be our policy."
>
> Hearings on HOLA, HR 4980, House Committee on Banking and Currency, 75th Congress, 1st Session, 23-24 (April 20, 1933)

Not only is there a dearth of evidence that Congress ever intended to occupy the field of contract and real property law and thereby allow the Bank Board to preempt State mortgage laws, but there are clear indications that Congress assumed that federal savings and loan associations would be subject to state and local statutes. Section 5(f) of HOLA, 12 USC § 1464(f), requires that every federally chartered savings and loan association be a member of the federal home loan bank system. A benefit of such membership is the ability to borrow money from the home loan bank against the security of "home mortgages." 12 USC § 1430, 47 Stat 731 (July 22, 1932). The term "home mortgages" is in turn defined as:

> "Such classes of first liens as are commonly given to secure advances on real estate by institutions authorized under this chapter to become members, under the laws of the State in which the real estate is located, together with the credit instruments, if any secured thereby."
>
> 12 USC § 1422(6), 47 Stat 725 (July 22, 1932), as amended, 76 Stat 779 (October 9, 1962)

It would be totally anamolous to suggest that Congress intended to provide the Bank Board with authority to preempt the terms of real estate mortgage contracts while expressly providing that all the mortgages which could be accepted by the Board to secure loans made to federally chartered savings and loan associations were to be governed by state law.

An even clearer and conclusive indication of congressional intent is found at 12 USC § 1428, 47 Stat 731 (July 22, 1932), which specifically authorizes the Bank Board to examine State laws regarding the terms of a mortgage. In pertinent part the statute reads:

> "The board shall cause to be made from time to time examination of the laws of the various States of the United States and the regulations and procedure thereunder governing conditions under which institutions of the kinds which may become members or non-member borrowers under this chapter are permitted to be formed or to do business, or relating to the conveying and recording of land titles, or the homestead and other rights, or to the enforcement of the rights of holders of mortgages on lands securing loans, or otherwise. If any such examination shall indicate, in the opinion of the board, that under the laws of any such State or the regulations or procedure thereunder there would be inadequate protection to a Federal Home Loan Bank in making or collecting advances under this chapter, the board may withhold or limit the operation of any Federal Home Loan Bank in such State until satisfactory conditions of law, regulation, or procedure shall be established. . . ."

The Bank Board's authority over local contract and real property laws is thus clearly limited to determine whether such laws are "satisfactory" and, if not, the Board is expressly authorized to limit the operation of any federal home loan bank in that state. The Board does not have the authority, as it has assumed, to simply abrogate the effectiveness of any such statute.[5]

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[5]

The ability of the Bank Board to "punish" states which refuse to enforce the due-on-sale clause by withholding the operation of a home loan bank in that state is interesting. Conceivably, such action, coupled with punitive actions by the secondary market, may whip a state into

Although the Bank Board utterly fails to find any congressional support for its preemptive power under HOLA,[6] it does cling to subsequent statements made by various members of Congress in the context of more recent legislation in order to provide some legitimacy to the Bank Board's current exercise of preemptive power. (See Bank Board's brief, pp 14-16) Without dwelling on such statements [this Court has characterized such *post hoc* statements as creating a "hazardous basis for inferring the intent of an earlier" Congress, *United States* v *Price*, 361 US 304, 313 (1960)], a short reply is warranted.

Initially, it must be observed that the statements referred to are at best vague references to the Bank Board's authority.

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line. Consumers in those states may also well face higher interest rates from lenders unable to enforce the due-on-sale clause and a move toward variable or renegotiable rate mortgages instead of long term fixed rate loans. The point, however, is that the people of each state would have the ability to decide through their elected officials whether they wish to suffer the consequences of being able to freely buy and sell encumbered property. Oddly, the Bank Board has neither claimed nor demonstrated that interest rates and mortgage terms between states which permit enforcement of the clause and those which do not are significantly different.

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[6]

The Board made one particularly feeble attempt to locate supporting legislative history by citing the testimony of its first chairman to the effect that the Board could "regulate mortgage instruments themselves in order to further the general purposes of the Act." (Bank Board's brief, at pp 13-14, fn 11) Classic to form, the statement is taken out of context since it was given in relation to possible homeowner speculation in government subsidized loans. More significantly, the Board fails to reveal that after its chairman stated "that (assignment prohibitions) could be in the bill and it could be enforced by regulations by the Board", Senator Couzens responded: "I doubt that it could be enforced by regulation." Senate Subcommittee of Committees in Banking and Currency, April 20, 1933, § 1317, 73rd Congress, 1st Session, Vol. 420, at p 14. In any respect, the bill did not contain any such prohibitions.

It cannot be determined, for example, whether the various Congressmen are referring to internal or external powers when speaking of the broad power of the Bank Board over the activities of federal savings and loan associations.

In citing the comments of Senator Brooke, it is interesting that the Bank Board ignores the remarks of the other half of the colloquy, those of Senator Proxmire. This may be because, following the citation of his remarks in prior briefs, the Senator was contacted by attorneys for the State of Michigan and he informed them that the quoted statements were prepared by and read into the record at the request of the Bank Board.[7] Upon being advised that his remarks were being quoted to support the Bank Board's putative preemptive powers, Senator Proxmire effectively repudiated his statement, explaining:

> "Mr. President, I am making these comments because I have just learned that Bank Board has cited my remarks of last October in its brief in defense of the appeal of the California case. Because I believe that the Board's citation of my comments was done in a manner which misinterprets the basis and intent of my remarks, I believe it is necessary for me to set the record straight."
>
> 125 Cong Rec, 2165-2166 (March 7, 1979)

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[7]

The State had been suspicious that such remarks could be ascribed to Senator Proxmire since he had previously told the chairman of the Bank Board with respect to the Board's belief that it could supercede state consumer protection law, that it was improper "to have a couple of bureaucrats overturn state legislature," (Hearings before the Senate Committee on Banking, Housing and Urban Affairs, 94th Congress, 1st Session, April 14-17, 1975) and because the Senator had chaired a Senate committee which issued a report in 1974 stating that the Bank Board "should not be given the power to overrule by stroke of the pen, the considered judgment of the state legislature and its governor. Only Congress should make such decisions if it is to be made at all." (Senate Report 93-902, U.S. Congressional Code and Administrative News, 6109 at 6123).

Contrary to the Bank Board's contention that Congress intended to empower the Board to promote uniform mortgage instruments, there is a wide body of law which supports the notion that Congress has always intended that mortgages should be construed within the framework of state legislation. The national housing act contains an express statement of congressional intent which is diametrically opposed to the Bank Board's policy concerning the due-on-sale clause. 12 USC § 1701(1), 64 Stat 81 (April 20, 1950), provides as follows:

> "It is the intent of Congress that no sale of a dwelling on which a mortgage is insured under this chapter . . . shall be made, while such mortgage is so insured, on terms less favorable to the purchaser as to amortization, retirement, foreclosure, or forefeiture than those contained in such mortgage."

Thus, under this policy, both VA and FHA insured mortgages held by federally chartered savings and loan associations are assumable, subject only to the buyer's qualifications. Numerous other federal statutes involving use of mortgages on real property expressly define the term "mortgage" as being subject to the laws of each state. See: 12 USC 1748a, 63 Stat 571 (August 8, 1979), an act to encourage construction of low cost private military housing; 12 USC 1707, 48 Stat 1247 (June 27, 1934); 12 USC 1749aa, 79 Stat 461 (August 10, 1965); 12 USC 1749aaa-5(7), 80 Stat 1276 (November 3, 1966); 12 USC 1750, 65 Stat 294 (September 1, 1951); 12 USC 1916(b), 76 Stat 888 (October 11, 1962); 42 USC 2304, 69 Stat 473 (August 4, 1955); 42 USC 4601(9), 84 Stat 1894 (February 2, 1971); 12 USC 1715y(b), 75 Stat 160 (June 6, 1961); 12 USC 1715v(3), 73 Stat 665 (September 23, 1959); 12 USC 1715l(c), 68 Stat 599 (August 2, 1954); 12 USC 1715z-7(b)(2), 82 Stat 599 (August 1, 1968); 12 USC 1715z-1(j)(2), 82 Stat 498 (August 1, 1968); 12 USC 1715w(b)(3), 73 Stat 663 (September 23, 1959); 12 USC 1736a, 55 Stat 55 (March 28, 1941).

Thus, despite numerous references in federal legislation to the use of real property mortgages, Congress has never attempted to provide a uniform system of mortgage law, nor has it ever expressed an intention that any agency possesses the power to alter state mortgage laws.

The Bank Board's assertion of preemptive power cannot be a substitute for congressional constitutionally based authority. The Board's rulemaking power is qualified by reference to the "best practices" of state savings and loan associations and does not grant authority to overrule State law or impair the equitable powers of the State judiciary. A regulation must carry out the intent of Congress as expressed by law, not agency intent. *United States* v *Larionoff*, 431 US 864, 873 (1977). In *Dixon* v *United States*, 381 US 64, 74 (1965), this Court appropriately held:

> "The power of an administrative officer or board to administer a federal statute and to prescribe rules and regulations to that end is not the power to make law . . . but the power to adopt regulations to carry into effect the will of Congress as expressed by the statute. A regulation which does not do this, but operates to create a rule out of harmony with the statute, is a mere nullity."

The Bank Board has cited numerous cases in support of its position.[8] On closer examination, however, these cases (none

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[8]

The Bank Board's attempt to attach significance to this Court's affirmance of *Conference of Federal Savings & Loan Associations* v *Stein*, 604 F2d 1256 (CA 9, 1979), aff'd 445 US 921 (1980) is unwarranted since "summary affirmances have considerably less precedential value than an opinion on the merits", *Illinois State Board of Elections* v *Socialists Workers Party*, 440 US 173, 180 (1979), and because the precedential effect of a summary affirmance can extend no further than the precise issues presented and "no more may be read into such action than was essential to sustain the judgment." *Mandel* v *Bradley*,

of which were decided by this Court) are singularly superficial and unilluminating. In lockstep fashion they unhesitatingly accept the assertion of the Board that it possesses "plenary authority to regulate virtually every aspect of the federal savings and loan industry." (See Bank Board's brief, p 16) It was only recently that the Fifth Circuit closely analyzed HOLA and declared with reference to the Board's litany of judicial support:

> "These cases, and others like them cited by the Board stand only for the proposition that federal law governs the internal management of federal savings and loan institutions." *Gulf Federal Savings & Loan Ass'n* v *Federal Home Loan Bank Board,* 651 F2d 259, 266 (CA 5, 1981)

In rejecting the Board's broad assertion of rulemaking authority, the Fifth Circuit concluded that "defining the limits of such power requires judicial, not administrative expertise." 651 F2d at 263. Thus, the rights of the parties to an agreement between a federal association and its customer must be determined under State, not Federal, law. 651 F2d at 266.

IV.

Conclusion

In its brief, the Bank Board repeatedly asserts that because it acts under federal statutes, it has unbridled authority to override state laws, public policies, commercial customs and political sensibilities. It makes such proclamations despite its recognition that any authority to preempt State laws must result from the intent of Congress. Yet it makes the least com-

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432 US 173, 179 (1977). In any respect, while the Court found procedural preemption in *Stein,* it expressly disclaimed applicability to substantive borrower rights, 604 F2d at 1260.

pelling demonstration that Congress ever intended to allow the Bank Board to overturn state mortgage and contract laws. In contrast to its position, federal policy, as articulated in various statutes ranging from national defense to disposal of atomic waste, is that the interpretation and definition of a "mortgage" is subject to the laws of each State.

Since the commencement of the national government, the execution of mortgages has been controlled by the laws of the several states. State law determines formal prerequisites to such an instrument, how they are to be construed, the extent and character of the security they afford the lender, and the nature of the borrower's obligation. State law controls delivery, interpretation of ambiguous terms, remedies of mortgagor and mortgagee for interference with their respective rights, payment, release and discharge, foreclosure proceedings by advertisement or order, and a myriad of related incidents.

There is no indication in the legislative history of HOLA that Congress intended to displace the traditional role of the states with respect to real estate matters, including enforcement of the due-on-sale clause. Had any such intention existed, it would have provoked vast and wide-ranging debate resulting in a clear cut indication by both the House and the Senate that Congress was prepared to delegate to an administrative agency in 1932 or 1933 the authority to preempt and displace the authority which the states had exercised over real estate transactions since the beginning of our national history. There simply is no such evidence. Despite its repeated assertions, the Board was never given the power to drastically alter traditional national-state relationships. Its "regulations" thus lack constitutional basis.

Prayer For Relief

The judgment of the Court of Appeals should be affirmed.

Respectfully submitted,

FRANK J. KELLEY
Attorney General

Louis J. Caruso
Solicitor General

Harry G. Iwasko, Jr.
Assistant Attorney General

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Assistant Attorney General

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Lansing, Michigan 48913
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(Other State Attorneys General
per cover)

Dated: March 26, 1982

Appendix

APPENDIX A

FEDERAL NATIONAL MORTGAGE ASSOCIATION
3900 Wisconsin Avenue, N.W.—Washington, D.C. 20016—

(202) 537-7000

DEPT. OF THE ATTORNEY GENERAL

FEB. 23, 1982

COMMERCE—RECEIVED

February 19, 1982

Robert Ianni
Assistant Attorney General
740 Law Building
525 West Ottawa Street
Lansing, Michigan 48913

Dear Mr. Ianni:

This will follow-up our telephone conversation and your original inquiry concerning FNMA's due-on-sale enforcement policy. Enclosed are related materials stating or discussing FNMA's policy to enforce due-on-sale provisions in its mortgage documents. The press releases deal with new program developments and include statements of FNMA policy regarding conventional loan assumptions and due-on-sale enforcement. Basically, FNMA enforces due-on-sale for all conventional mortgages purchased pursuant to commitments issued on and after November 10, 1980 and for all conventional mortgages covering properties whose sale has been facilitated by wraparound or second mortgages made by institutional lenders. (This policy, of course, is subject to change in favor of full enforcement of due-on-sale.)

Also enclosed for your information is a letter of comment dated November 23, 1981 on the Comptroller of the Currency's

proposed regulation authorizing due-on-sale enforcement by national banks.

In addition, to the extent permitted by applicable law, FNMA accelerates the maturity of loans backing its mortgage pass-through certificates when the properties securing the loans are conveyed so as to trigger the due-on-sale clauses in the mortgage instruments. The enclosed Supplement to Prospectus describes the due-on-sale policy applicable to loans which back FNMA's guaranteed mortgage pass-through certificates. You will note that FNMA must warrant that at least 50% of the principal balances of the loans in the mortgage pool must be from states other than those which substantially restrict lenders from enforcing due-on-sale (see page 4 of the Supplement). This reflects the secondary mortgage market's preference for enforcement of due-on-sale.

Lenders governed by state law restrictions on FNMA's enforement policy must include "call option" provisions, under which the lender has the option to require full repayment of the loan during a 30-day period beginning seven years after the date of the loan. (Because of federal preemption, loans originated by federally-chartered savings and loan associations and federally-chartered credit unions need not contain call option provisions.) The fourteen states in which FNMA currently requires a seven-year call option are: Arizona, California, Colorado, Florida, Georgia, Illinois, Iowa, Michigan, Mississippi, New Mexico, Ohio, South Carolina, Utah and Washington.

Please let me know if you need any futher information concerning FNMA's policy on this matter.

Sincerely,

John Mansfield /s/
John T. Mansfield
Assistant General Counsel

Enclosures
JTM:jcd

APPENDIX B

THE MORTGAGE CORPORATION

Federal Home Loan Mortgage Corporation
1776 Street NW, P.O. Box 37248
Washington, D.C. 20013

October 13, 1981

Robert Ianni
Assistant Attorney General
State of Michigan
Department of Attorney General
740 Law Building
525 West Ottawa Street
Lansing, MI 48913

Dear Mr. Ianni:

This is in response to your letter dated September 23, 1981 regarding the Corporation's policy concerning the enforcement of the due-on-sale clause.

The Mortgage Corporation's current due-on-sale policy for loans it owns in whole or in part requires that upon a transfer of ownership in the property, the review of the creditworthiness of the prospective transferee be completed. If the transferee's credit is found to be satisfactory based on our enclosed underwriting guidelines, the Mortgage Corporation requires its servicing lender to permit the transfer. The Mortgage Corporation will not consent to a transfer of real estate or an interest therein, if the transferee is found uncreditworthy or the transfer does not provide adequate credit information. The Corporation requires the servicing lender to accelerate the indebtedness if the property is transferred to an uncreditworthy individual.

The Corporation currently prohibits any alteration of the interest rate on mortgage loans purchased by it. If, at the time of transfer, the lender wishes to increase the interest rate, the lender must repurchase the loan from the Corporation. The nature of our financing system has limited our ability to alter the contract rate on mortgages purchased by the Corporation. However, the Corporation fully supports the ability of lenders to exercise the due-on-sale clause by accelerating the indebtedness or by increasing the interest rate upon the sale or transfer of mortgaged property.

Because of continued inflationary pressures, rising interest rates in both the mortgage and money markets, and the growing demand of capital market investors for market sensitive investment instruments, the Mortgage Corporation has undertaken a serious reconsideration of its policy of allowing automatic loan assumptions by creditworthy individuals. Without the ability to satisfy the investment needs and demands of capital market investors through a viable and market sensitive mortgage investment vehicle, the ability of the Corporation to act as a conduit between the capital and mortgage markets could be seriously impeded. As a national mortgage market support system created by Congress, the Corporation has a clear mandate to react to continued economic pressures in order to maintain its role as a facilitator of available mortgage credit on a nationwide basis. The revision of our policy of allowing automatic assumptions to any creditworthy individual is an important step toward maintenance of this national mortgage credit delivery system.

The Mortgage Corporation is now studying the legal and operational alternatives as they relate to the following options to enforce due-on-sale clauses in mortgage loans purchased by us:

1. Requiring the escalation of interest rates upon the sale or transfer of mortgaged property to the current market rate and the pass-through of the escalated rate to investors in FHLMC mortgage-backed securities and/or the repurchase of the escalated mortgage by the originating lender.

2. Requiring the escalation of interest rate upon the sale or transfer of mortgaged property to the current market rate and the retention of the escalated rate as FHLMC earnings.

We will, at least, continue that portion of our current policy which requires satisfactory credit underwriting of all transferees in a sale or transfer of mortgaged property.

The Corporation is also considering its alternatives in order to overcome the problems created when a particular state has, by judicial ruling or statute, restricted a lender's ability to increase the interest rate on a mortgage at the time of property sale or transfer. In these cases, our options likely would be limited to ceasing our purchase activity in such marketplaces or, more likely, purchasing only those mortgages which contain a "call" provision. The "call" provision option is one that has recently been undertaken by the FNMA in several states including Michigan. We believe that the ability to escalate interest rates to a current market rate only at the time of transfer or sale would be a far more equitable solution than requiring a "call" provision in all future traditional fixed rate mortgage instruments. A "call" provision of this type tied to a specified call date (never more than 7 years in FNMA's case) would be applied to *all* future mortgages purchased from the particular state, whether or not the property has been transferred to a new homeowner. On the other hand, if we are able to raise rates to a market level *at the time of transfer*, and therefore avoid the "call" option, homeowners could maintain

the benefits of a traditional fixed-rate conventional loan during the period of their ownership.

The Mortgage Corporation has a real interest in the ability of lenders to exercise the due-on-sale clause, since such a clause is contained in the FNMA/FHLMC uniform mortgage instruments. The use of our standard documentation is required by the Corporation for any lender selling home loans to us. When the Federal National Mortgage Association (FNMA) and the Mortgage Corporation designed the uniform mortgage instrument, the goal was to create instruments which would be used by lenders on a national basis, whether they sold loans to us or to private investors, or retained them in their portfolios. Through standardization of lending instruments, public and private secondary market investors are able to purchase mortgages, thousands of miles removed from the investor, with preknowledge of the governing terms, conditions and covenants of that investment.

Enclosed is our uniform mortgage documentation prepared for use in the Michigan (1 to 4 Family, 6/75, FNMA/FHLMC uniform mortgage instrument). Uniform Covenant 17 (the due-on-sale clause) contained in this instrument requires, among other things, that upon the sale or transfer of mortgage property, or an interest therein, the written consent of the lender is required in regard to the creditworthiness of the transferee and that the interest rate will be set at the rate the lender shall request. Otherwise, the lender can accelerate the indebtedness and call the loan due and payable upon the transfer of the mortgaged property.

Amicus Brief

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No. 81-750

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,

Appellants,

vs.

REGINALD D. DE LA CUESTA, et al.,

Appellees.

On Appeal from the California Court of Appeal for the Fourth Appellate District

AMICUS CURIAE BRIEF OF THE NATIONAL ASSOCIATION OF REALTORS® IN SUPPORT OF APPELLEES

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AMICUS CURIAE BRIEF OF THE NATIONAL ASSOCIATION OF REALTORS® IN SUPPORT OF APPELLEES*

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* All parties of record in this case have consented pursuant to Supreme Court Rule 36.2 to the filing of this amicus brief in support of appellees. These consents are filed herewith.

INTEREST OF THE NATIONAL ASSOCIATION OF REALTORS®

I. Identity Of The National Association Of Realtors®

The concern and perspective of the National Association of Realtors® (NAR) in the consideration of this appeal can be better understood if the purpose and nature of NAR is appreciated.

Founded in 1908, NAR is headquartered in Chicago, Illinois. It is a non-profit professional association of persons engaged in all phases of the real estate business, including, but not limited to, brokerage, appraising, management, and counseling.

NAR was created to promote and encourage the highest and best use of the land, to protect and promote private ownership of real property, and to promote professional competence. In pursuit of these objectives, NAR is concerned with a wide range of activities, including real estate education, arbitration of member and public controversies, equal opportunity in housing, real estate licensing, public service, neighborhood revitalization, and legislation relating to the real estate business.

NAR is the owner of various registered service and collective membership marks, including the mark "REALTOR®". Over the years NAR has promoted a public understanding of the term "REALTOR®" as identifying a member of NAR engaged in the real estate business and subscribing to and bound by a strict Code of Ethics.

Today, the membership of NAR includes 50 State Association of REALTORS®, over 1,700 Member Boards of REALTORS®, and more than 600,000 REALTOR® and REALTOR-ASSOCIATE® members.

II. The Impact Of This Case On The Present Market For Real Property

The depressed state of the housing industry, and particularly the market for existing homes, is a fact that this Court may judicially notice. Fed. R. Evid. 201. The housing industry has been brought to a virtual standstill by the exceedingly high home mortgage interest rates that have persisted for nearly forty months. High mortgage interest rates have produced one of the most prolonged housing industry downturns since World War II. NAR, *Existing Home Sales*, February, 1982.

Reacting to current mortgage interest rates, many real estate brokers and salespeople have attempted to assist buyers and sellers in finding alternatives to the traditional long term fixed rate home mortgage that is now priced beyond the reach of most Americans, particularly first time homebuyers. These efforts have lead to the development of so-called "alternative," "creative," or "people to people" financing techniques, the purpose of which is to reduce the cost of financing a real estate transaction.

In the typical "alternatively financed" real estate transaction, a buyer will assume the seller's existing mortgage, and the seller will take back a second mortgage to secure a note that typically requires the buyer to repay the balance of the sale price within three to five years. In a recent NAR membership survey, ninety-four percent of the respondents stated that they participated in a real estate transaction involving "alternative" financing techniques. NAR, *Attitudes of Real Estate Industry*, February, 1982 at p. 8. This same survey showed that as of January, 1982, seventy percent of all real estate transactions involved a "people to people" financing technique. *Id.* Of those "alternatively" financed transactions, mortgage assumptions are the most widely

used "alternative" financing technique, with an assumption now involved in four out of every ten single-family transactions. *Id.* at 9.

Clearly, a determination of the circumstances under which savings and loan associations may exercise their rights under a due-on-sale clause will have a direct and immediate impact upon the extent to which mortgage assumptions will continue as a method of reducing the total cost of financing a real estate transaction. It is also clear that if due-on-sale clauses are construed as prohibiting mortgage assumptions at rates less than the current prevailing mortgage interest rates, then sales of existing single-family homes will plummet even more sharply, and the increased cost of financing will further reduce the value of current homeowners' equity.

SUMMARY OF ARGUMENT

The issue presented for this Court's decision is whether Congress has conferred upon the Federal Home Loan Bank Board ("Bank Board") the authority to preempt the substantive contract and real property laws of the various states regarding the enforcement of due-on-sale clauses.

It is undisputed that the laws of contracts and real property have been, since before the ratification of the federal Constitution, matters traditionally reserved to the courts and legislatures of the various states. While the federal government has brought large segments of the American economy under the control of federal regulatory agencies, Congress has yet to create a federal body of contract and real property law to supplant the common and statutory law of the various states.

The appellants and the Bank Board assert, however, that Congress did precisely that when it empowered the Bank Board to create and regulate federal savings and loan associations under the Home Owners' Loan Act of 1933 ("HOLA"). The Bank Board asserts that its undisputed power to define the manner in which the products and services of a federal savings and loan association will be delivered to the public also includes the power to determine, by administrative regulation, how contracts defining those products and services will be interpreted by courts. In addition, the Bank Board contends that Congress authorized it to make these determinations according to a standard measured by the financial status of the federal association. Bank Board's Amicus Br. at 20.

There is nothing in HOLA, its legislative history, or the reasoned case law that suggests that Congress ever intended to grant to the Bank Board the authority it now claims. On the contrary, Congress has specifically instructed the Bank Board that it should alter the operations and practices of federal associations if it concludes, in its regulatory wisdom, that applicable state law does not protect the associations' interests. Nowhere has Congress suggested that perceived risks posed by state law to the fiscal well-being of federal institutions could be minimized or eliminated by administrative exemption from, or preemption of, such law.

The weight of the case law supports this conclusion. Most courts have drawn a distinction between the structure, operations, and marketing practices of federal savings and loan associations, and the content and interpretation of contracts between federal savings and loan associations and their customers. The Bank Board has plenary authority to regulate the former to the exclusion of conflicting or competing state law, while the latter is a matter to be resolved under the law of the appropriate

state. Courts that have applied this distinction have all held that the interpretation of a due-on-sale clause is a matter of state contract law, which is not subject to preemption by the Bank Board.

The Bank Board, however, does not view its preemptive powers under HOLA to be limited to state laws of contract and real property. The interpretation of HOLA advanced by the Bank Board permits it to preempt *any* state law that it believes could adversely affect a federal association's financial status. This power claimed by the Bank Board poses a threat to a state's sovereignty that has not heretofore been countenanced by Congress. Had Congress granted this authority to the Bank Board, the sovereignty of the states would have been so drastically impaired that such delegation would have been unconstitutional.

ARGUMENT

I.

INTRODUCTION

In 1933 Congress passed the Home Owners' Loan Act, 12 U.S.C. §§ 1461-1470, which contains the following grant of authority to the Bank Board to regulate federal savings and loan associations:

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation of associations to be known as "Federal Savings and Loan Associations" . . ., and to issue charters therefor, giving primary consideration to the best

> practices of local mutual thrift and home-financing institutions in the United States.

12 U.S.C. § 1464(a)(1).

In 1976, purporting to act in accordance with this authority, the Bank Board promulgated the following regulation:

> A Federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's consent.

12 C.F.R. § 545.8-3(f).

The Bank Board went further, however, than simply authorizing federal associations to include due-on-sale clauses within their security instruments if deemed appropriate. The Bank Board also announced the "policy" that "Federal associations shall not be bound by or subject to any conflicting state law which imposes different . . . due-on-sale requirements. . . ." 41 Fed. Reg. 18286, 18287 (1976).

On July 31, 1981, the Bank Board reaffirmed this policy, plainly conceding that its purpose was to insulate federal associations from the "economic risks associated with mortgage lending" by abrogating certain provisions of state law it felt created or enhanced those economic risks.[1] 46 Fed. Reg. 39123 (1981) (to be codified at 12 C.F.R. § 556.9).

---

[1] One can only speculate on the reasons for the Bank Board's belief that such a reaffirmation was necessary, given its steadfastly consistent position that its regulations preempted state law in this area.

In 1978, the California Supreme Court decided in *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379 (1978) that a due-on-sale clause contained in a security instrument would not "be enforced upon the occurrence of an outright sale unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default." 21 Cal. 3d at 953. The basis for this holding was a California statute proscribing "conditions restraining alienation."[2] The court concluded that permitting enforcement of the due-on-sale clause, except under the limited circumstances of security impairment or risk of default, constituted such a "restraint on alienation" and was therefore impermissible under California law.[3]

The Bank Board's regulation purports to prohibit the application of the *Wellenkamp* rule to federal savings and loan associations. Congress did not grant such vast power to the Bank Board, and thus the Bank Board's attempt to exercise it is void.

II.

REGULATIONS PROMULGATED BY A FEDERAL AGENCY CAN PREEMPT STATE LAW ONLY IF THEY FALL WITHIN THE AGENCY'S STATUTORY AUTHORITY CONFERRED BY CONGRESS.

The Supremacy Clause of the United States Constitution clearly indicates that the laws of the states shall yield to those of the federal government where a conflict exists:

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[2] Cal. Civ. Code § 711 (West 1954).

[3] The holding in *Wellenkamp* has since been extended to security interests which secure loans for the purchase of commercial property, and for instruments created by noninstitutional lenders. *Dawn Investment Co. v. Superior Court of Los Angeles County*, 30 Cal. 3d 695 (1982).

> This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; . . . shall be the supreme Law of the Land. . . .

U.S. Const., Art. VI, cl. 2.

Congress therefore possesses the authority to enact legislation that supercedes state law, subject to the other limitations on federal power set forth in the Constitution. *See Jones v. Rath Packing Co.*, 430 U.S. 519 (1977); *Rice v. Santa Fe Elevator*, 331 U.S. 218 (1947). Furthermore, once Congress has legislatively declared a federal policy, it may empower an agency to effectuate that policy by enacting interpretative regulations. *See Carlson v. Landon*, 342 U.S. 524 (1952); *Yakus v. United States*, 321 U.S. 414 (1944).

Regulations properly promulgated by a federal agency under a valid statutory delegation have the force of law, and thus have preemptive effect. *Free v. Bland*, 369 U.S. 663 (1962); *United States v. Shimer*, 367 U.S. 374 (1961); *United States v. Mersky*, 361 U.S. 431, 437-38 (1960). The converse is equally true. Where the agency regulates in an area or manner inconsistent with the authorization conveyed by the underlying statute, the regulations are invalid, and do not preempt state law. *Ridgway v. Ridgway*, 50 U.S.L.W. 4006 (U.S. Nov. 10, 1981); *Whirlpool Corp. v. Marshall*, 445 U.S. 1 (1980).

In this case, the Bank Board's regulation clearly conflicts with *Wellenkamp*: *Wellenkamp* holds that a due-on-sale provision in a mortgage contract is enforceable only under certain conditions, and the Bank Board's regulation holds that such a limitation imposed by state law is inapplicable to federal savings and loan associations. Whether *Wellenkamp* will survive the Bank Board's preemptive attack depends upon whether Congress empowered the Bank Board to preempt state law governing due-on-sale clause enforcement.

III.

THE BANK BOARD'S DUE-ON-SALE REGULATIONS ARE OUTSIDE THE SCOPE OF THE BANK BOARD'S STATUTORY AUTHORITY AND THEREFORE DO NOT PREEMPT STATE LAW.

A.

The Language Of HOLA Does Not Express Congress' Intent That The Bank Board Have The Power To Supercede State Contract Or Real Property Law.

Nothing in HOLA, expressly or impliedly, empowers the Bank Board to preempt the state law of contracts applicable to the security instruments of federal savings and loan associations. On the contrary, the language and structure of HOLA demonstrates that Congress clearly contemplated two parallel systems to deliver savings and loan services to the public: the federal system administered by the Bank Board, and a corresponding system administered by state regulatory agencies. While Congress contemplated manifestly that the state and federal delivery systems for home financing might differ, there is no evidence to suggest that it intended that the "product" (notes and mortgages) to be delivered by the federal system would be governed by a set of legal standards totally different from the standards governing the products delivered by the state system.

Congress' directive to the Bank Board to prescribe rules and regulations regarding the investments of federal associations contains no suggestion that the Bank Board's regulatory authority includes the authority to amend state law governing the interpretation of the contractual terms of such investments. On the contrary, Congress has described precisely what the Bank Board should do if it determines there is cause for concern regarding state law applicable to the mortgage lending activity of federal associations. And the Bank Board's

options do not include preemption of state law. Rather, section 1428 of the Federal Home Loan Bank Act[4] provides:

> If [the Bank Board's] examination [of the laws of a state governing the enforcement of the rights of holders of mortgages on lands securing loans] shall indicate, in the opinion of the board, that under the laws of any such State or the regulations or procedure thereunder there would be inadequate protection to a [federal savings and loan association] in making or collecting advances under this chapter, *the board may withhold or limit the operation of any [federal savings and loan association] in such State until satisfactory conditions of law, regulation or procedure shall be established.* . . .

12 U.S.C. § 1428 (emphasis added).

Thus, if the Bank Board believes that state law governing real property loan or mortgage contracts does not adequately protect federal associations, Congress has directed the Bank Board to limit the activities of the *associations* within that state. Congress plainly did not intend that the Bank Board should pursue the alternative of unilateral and arbitrary alteration of the objectionable provisions of state law. This alone compels the conclusion that Congress did not grant the Bank Board authority to change state laws governing enforcement of due-on-sale clauses.

This conclusion is further supported by HOLA's provisions relating to the ability of federal associations to act in the capacity of trustee, executor, administrator, guardian, or fiduciary. Section 1464(n) of HOLA provides:

> (1) The Board is authorized and empowered to grant by special permit to an association applying therefor, *when not in contravention of State or local*

[4] 12 U.S.C. §§ 1421-1449.

> *law*, the right to act as trustee, executor, administrator, guardian, or in any other fiduciary capacity in which State banks, trust companies, or other corporations which come into competition with associations are permitted to act under the laws of the State in which the association is located. . . .
>
> (2) *Whenever the laws of such State authorize or permit the exercise of any or all of the foregoing powers by State banks, trust companies, or other corporations which compete with associations*, the granting to and the exercise of such powers by associations shall not be deemed to be in contravention of State or local law within the meaning of this section.

12 U.S.C. § 1464(n) (emphasis added).

Congress has therefore expressly permitted the Bank Board to authorize a federal association to act as a fiduciary to the same extent as state banks, trust companies or other corporations are permitted to do so by state and local law. Subsection (2), however, declares Congress' intent that any provision of state or local law would not apply if it otherwise prohibited a federal association from acting in such a capacity while permitting the same activity by state institutions.

Congress felt compelled, then, specifically to articulate in HOLA the exact circumstances under which state and local laws governing the exercise of trustee, executor, administrator or fiduciary powers, traditionally the province of the states, would be inapplicable to federal associations. Thus, although the Bank Board was given broad authorization to "grant by special permit to an association applying therefor" the right to act as a trustee, that authorization did not inherently also include the power to exempt federal associations from the operation of state or local laws which might otherwise prohibit or restrict federal associations from acting

in such capacity. Had the Bank Board's authorization by Congress included the power to negate state and local law limiting such practices of federal associations, subsection (2) would have been superfluous. By including subsection (2), Congress acknowledged that HOLA's general grant of authority to the Bank Board to regulate federal savings and loan associations did not include the power to alter and make inapplicable any state or local laws which would otherwise restrict federal associations wishing to exercise trust powers.[5]

Just as there is nothing in the Bank Board's general regulatory authority that permits the Board to preempt state fiduciary law, there is also nothing in the Board's general authority that permits the Board to preempt state contract or real property law.

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[5] Indeed, the section of HOLA addressed to the exercise of trustee powers by federal associations was enacted by the Congress in 1980 as part of the Depository Institutions Deregulation and Monetary Control Act of 1980, P.L. 96-221, § 403, 94 Stat. 132, 151 (1980) well after the Bank Board had concluded by promulgation of 12 C.F.R. § 545.8-3(f) that it could override state laws interpreting the mortgage contracts between federal associations and borrowers. This is further evidence that Congress recognized that the Bank Board did not possess the authority, by virtue of its directive to the Bank Board to "provide for the organization, incorporation, examination, operation and regulation of associations," to create an exemption from contrary state law for federal associations desiring to act as trustees.

B.

Courts Have Not Interpreted HOLA To Grant The Bank Board Broad Authority To Amend State Contract And Property Law Applicable To Federal Savings And Loan Associations.

HOLA commands the Bank Board to regulate the "operations" of federal savings and loan associations. But when this statutory authorization is placed in its proper context it becomes clear that "operations" refers to the manner in which federal associations make their products and services available to the public. The Bank Board, however, claims that the power to regulate a federal association's operations includes the authority not only to regulate a federal association's "delivery" system, but also to rewrite the state law that defines and interprets the products and services it delivers. The case law, however, firmly supports the distinction between the law governing the manner in which federal savings and loan associations deal with their customers and the public, which is subject to the exclusive control of the Bank Board, and the law governing the form and interpretation of the products and services that the association offers, which is solely a matter of state contract and real property law.

Even the famous "cradle to grave" opinion in *California v. Coast Federal Savings and Loan*, 98 F.Supp. 311 (S.D. Cal. 1951) is wholly consistent with this analytical framework. There, California attempted to compel Coast Federal Savings, a federal association, to comply with California law governing the operations of financial institutions. Concluding that HOLA conferred on the Bank Board the exclusive authority to regulate the operations of federal savings and loan associations, the Court quite logically held that California law imposing different regulatory standards was preempted.

The *Coast Federal* principle that Bank Board regulatory authority over federal association operations is plenary has been consistently applied by courts whenever the issue involves the *manner* in which federal savings and loan associations deliver their products and services to the public. *North Arlington National Bank v. Kearny Federal Savings and Loan Association*, 187 F.2d 564 (3rd Cir. 1951) (Bank Board has authority to permit federal savings and loan associations to have branch offices.); *see also Lyons Savings and Loan Association v. Federal Home Loan Bank Board*, 377 F.Supp. 11 (N.D. Ill. 1974); *Central Savings & Loan of Chariton, Iowa v. Federal Home Loan Bank Board*, 422 F.2d 503 (8th Cir. 1970) (Bank Board has authority to permit federal associations to deliver financial services via a "mobile facility".); *Bloomfield Federal Savings and Loan Association v. American Community Stores Corporation*, 396 F.Supp. 384 (D. Neb. 1975) (Bank Board regulations permit use of an electronic fund transfer service.); *City Federal Savings and Loan Association v. Federal Home Loan Bank Board*, 600 F.2d 681 (7th Cir. 1979) (Bank Board has authority to issue regulations permitting "limited facility branch offices".); *Kupiec v. Republic Federal Savings and Loan Association*, 512 F.2d 147 (7th Cir. 1975) (Bank Board regulations governing the right of members of association to receive, and obligation of association to provide, access to list of members of association preempt state law.); *First Federal Savings and Loan Association of Boston v. Greenwald*, 591 F.2d 417 (1st Cir. 1979) (Bank Board regulations governing interest payments on tax escrow accounts are "internal" and therefore preempt state law.); *Rettig v. Arlington Heights Federal Savings and Loan Association*, 405 F. Supp. 819, 823 (N.D. Ill. 1975) (Bank Board regulations govern the authority of federal institutions to sell insurance and liability of corporate officers for mis-

appropriation of a corporate opportunity to sell insurance and liability of corporate officers for misappropriation of a corporate opportunity to sell insurance.); *Murphy v. Colonial Federal Savings and Loan Association*, 388 F.2d 609 (2d Cir. 1967) (Federal law governs access to association membership list.).

But where the issue is the construction and interpretation of a loan contract executed by a borrower and a federal savings and loan association, the issue has not been viewed as involving the "manner" of delivery, but rather an issue going to the very essence of the "product delivered," a legal relationship defined by state law.

This was the Fifth Circuit's holding in *Gulf Federal Savings and Loan Association of Jefferson Parish v. Federal Home Loan Bank Board*, 651 F.2d 259 (5th Cir. 1981). There, the Bank Board ordered Gulf Federal Savings and Loan to discontinue certain practices concerning the method by which borrowers were charged interest on their loans. The Bank Board concluded that Gulf Federal's methods were inconsistent with the terms of the loan contracts between itself and its borrowers and thus a "breach" of such contract in violation of Federal common law. The Fifth Circuit refused to enforce the Bank Board's order because it dealt with the construction and interpretation of a contract rather than the manner in which Gulf Federal marketed its products and services to the public. The Fifth Circuit explained its rationale as follows:

> These cases, and others like them cited by the Board, stand only for the proposition that federal law governs the *internal management* of federal savings and loan institutions.
>
> Gulf Federal's conduct in this case, however, has nothing to do with the internal management of the association. The disputed loan agreement provision is part of a contract between the association and its borrowers. Such contracts do not implicate the

> sound management of the savings and loan or the insurance liability of the government, nor do they require a uniform federal rule to assure sound and well-managed savings and loan institutions (citation omitted). . . . Gulf Federal's loan agreements were made under Louisiana law, and Louisiana law must determine the rights of the parties to the contract.

651 F.2d at 266 (emphasis in original).

To the same effect is the Ninth Circuit's opinion in *Conference of Federal Savings and Loan Association v. Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.* 445 U.S. 921 (1980). The issue in *Stein* was the applicability to federal savings and loan associations of certain portions of California law prohibiting discrimination in the availability of credit. Both California law and the regulations of the Bank Board prohibited certain forms of discriminatory lending practices, but each imposed different procedural requirements for enforcing those prohibitions. Holding that the Bank Board's requirements superceded those of the state, the Ninth Circuit was careful to explain that its holding dealt only with operational or procedural matters, and *not* the substantive rights of borrowers to be free from discriminatory lending practices:

> The state act and the regulations of the Bank Board can be divided into two groups. First are the substantive nondiscrimination provisions—those conferring substantive rights upon borrowers to be free from discriminatory practices in the lending of money or extending of credit. No dispute presently exists as to those. . . . Whether preemption exists as to them is a question we need not and do not reach.
>
> Constituting a second group are the procedural aspects of the Act and the federal regulations—

> those providing for *regulatory control over the lending institutions* to insure that the substantive rights of borrowers are respected. These include regulations providing for monitoring, for enforcement and complaint resolution mechanism and for notice. It is the regulatory authority of appellant over the federal associations in these respects that is here in dispute.

604 F.2d at 1260 (emphasis added).

This same analysis was applied in *Kirkland v. Fidelity Federal Savings and Loan Association of Jacksonville*, No. 79-859-Civ-J-B (M.D. Fla. May 16, 1980),[6] where the court held explicitly that construction of the due-on-sale clause in plaintiff's mortgage contract was governed by state, not federal law. The court reasoned as follows:

> Defendants argue that federal regulation has totally preempted the law in this case and that the Court must look solely to federal law and regulations as it does, for example, in the area of labor law. (citation omitted). Defendant's contention would be correct if plaintiff were challenging the validity or interpretation of the federal regulations. Further, if the state were attempting to place additional regulations on a federally chartered savings and loan, it would be precluded from doing so by federal preemption.
>
> However, plaintiffs in this case raise an entirely different question. They do not challenge the validity of the "due-on-sale" clause nor request an interpretation of the federal regulation. Nor is this a case in which the state is attempting to regulate the practices of a federal association. Plaintiffs instead ask only for an interpretation of the

[6] A copy of the *Kirkland* opinion is reproduced as an Appendix to this brief.

> mortgage contract. *They raise questions governed by contract and real property law. The law of real estate mortgages has not been totally preempted by federal law even though the mortgage is issued by a federally chartered lending institution.*

Appendix to this Brief at 3a-4a (emphasis added).

Similarly, the Supreme Court of Minnesota has recognized that a due-on-sale clause is not part of the "delivery system" of federal savings and loan associations, but rather a matter of state contract law that is not subject to Bank Board preemption. In *Holiday Acres No. 3 v. Midwest Federal Savings and Loan Association of Minneapolis*, 308 N.W. 2d 471 (Minn. 1981) the court held that:

> The fact that the federal government may preempt by occupation the field of the internal affairs of federal savings and loan associations does not mean that there is preemption in the field of non-internal affairs such as the validity of contractual provisions contained in mortgages between loan associations and mortgagors.
>
> . . . We are not persuaded that state law concerning the exercise of due-on-sale clauses in any way touches upon the regulation or operation of the internal affairs of federal savings and loan associations.

308 N.W. 2d at 478.

Thus, the Bank Board may not alter the substantive state law governing the products and services of a federal savings and loan association, and, therefore, the Bank Board regulation at issue here does not preempt state law.

It is only logical that this distinction should be drawn between the Bank Board's regulatory authority over the operations of a federal savings and loan association, and

the interpretation of a contract between an association and its customer. Otherwise, state courts could find themselves in the peculiar position of having to construe the contract and property rights appurtenant to one parcel of land under state law, and the contract and property rights appurtenant to the adjoining parcel under federal law.[7] Moreover, the choice of applicable law would be dictated by the wholly fortuitous circumstance of the property owner's choice of financing. There is nothing in HOLA that indicates that this was Congress' intent.

The only cases that suggest a contrary conclusion are *Meyers v. Beverly Hills Federal Savings and Loan Association*, 499 F.2d 1145 (9th Cir. 1974) and *Glendale Federal Savings and Loan Association v. Fox*, 459 F. Supp. 903 (C.D. Cal. 1978), *rev'd on other grounds*, 663 F.2d 1078 (9th Cir.), *petition for cert. filed*, 50 U.S.L.W. 3518 (U.S. Dec. 21, 1981) (No. 81-1192). The issue in *Meyers* and *Glendale* was whether the Bank Board's regulations preempted California law governing prepay-

[7] This possible result is graphically illustrated by the Uniform Mortgage Instrument promulgated jointly by the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC), the pertinent provisions of which are set forth in the Appendix to this brief. This Instrument provides that the borrower convey to the lender "all easements, rights, appurtenances, rents, royalties, mineral, oil and gas rights and profits, water, water rights, water stock, and all fixtures now or hereafter attached to the property." Each of these interests conveyed to the lender have traditionally been defined by state law. If the Bank Board has the power to change these interests as they relate to a federal savings and loan association, then each of these rights attaching to a tract of land could vary depending upon the status of the party holding the lien or security interest.

ment penalties and due-on-sale clauses respectively. Holding that the Bank Board regulations preempted state law, both courts relied merely upon the general proposition derived from *Coast Federal* that the Bank Board has plenary authority to regulate the operations of a federal savings and loan association. Neither court analyzed the factual context in which *Coast Federal* was decided, or whether state law governing prepayment penalties or due-on-sale clauses involves the operations of a federal savings and loan association or the interpretation and construction of a contract. It is also significant that *Meyers* and *Glendale* were both decided before *Gulf Federal* and *Stein*. *Gulf Federal* and *Stein* have since made clear that a determination of the nature of the state and federal laws at issue is critical to the issue of federal preemption. The precedential value of *Glendale* is even further compromised by the recent reversal of the decision by the Ninth Circuit. *See* 663 F.2d 1078 (9th Cir.), *petition for cert. filed*, 50 U.S.L.W. 3518 (U.S. Dec. 21, 1981) (No. 81-1192).[8]

---

[8] There does exist a line of cases, relying upon *Glendale*, which hold that the Bank Board's regulations do in fact preempt state law governing due-on-sale clause enforcement. Since each of these cases relies upon *Glendale*, they each suffer from the same fatal flaws as *Glendale* itself. *See Williams v. First Federal Savings and Loan Association of Arlington*, 651 F.2d 910 (4th Cir. 1981) (dicta only, indicating that Bank Board regulations would preempt state law, relying on *Glendale*); *Price v. Florida Federal Savings and Loan Association*, No. 79-974-Civ-J-M (M.D. Fla. September 1, 1981); *Collins v. First Federal Savings and Loan Association of Walla Walla*, No. C-8-334 (E.D. Wash. June 3, 1981); *First Federal Savings and Loan Association of Phoenix v. Development & Management Enterprises*, No. CIV 79-880 PHX-EHC (D. Ariz. April 3, 1981); *First Federal Savings and Loan Association of Gasden County v. Peterson*, 516 F.Supp. 732 (N.D. Fla. 1981); *Great Western Union Federal Savings and Loan Association v. Walters*, No. C79-906V (W.D. Wash.

(Footnote continued on following page)

IV.

THE INTERPRETATION OF HOLA ADVANCED BY THE BANK BOARD IS CONTRARY TO THE CONCEPTS OF FEDERALISM EMBODIED IN THE FABRIC OF THE CONSTITUTION AND THE TENTH AMENDMENT.

This Court has held that the tenth amendment:[9]

> . . . is not without significance. The Amendment expressly declares the Constitutional policy that Congress may not exercise power in a fashion that impairs the States' integrity or their ability to function effectively in a federal system.

Fry v. United States, 421 U.S. 542, 547 n.7 (1975).

In *National League of Cities v. Usery*, 426 U.S. 833 (1976), this Court applied this principle and prohibited Congress from exercising its commerce power to extend the federal minimum wage law to state and local governmental employees. This Court has therefore recognized explicitly that Congress is barred from exercising its commerce power in a manner that drastically impairs the states' ability to function as coordinate sovereigns in a federal system. This conclusion is derived from the

---

[8] *continued*

June 18, 1980); *Dantus v. First Federal Savings and Loan Association of Denver*, 502 F.Supp. 658 (D. Colo. 1980); *Bailey v. First Federal Savings and Loan Association of Lenawee County*, No. 80-01-756 (Cir. Ct. for Lenawee Cty. Mich. January 21, 1982); *First Federal Savings and Loan Association of Rochester v. Jenkins*, 441 N.Y.S. 2d 373 (Super. Ct. of Tompkins Cty. 1981); *Haugen v. Western Federal Savings and Loan Association of Denver*, 633 P.2d 497 (Colo. App. 1981); *Dunham v. Ware Savings Bank* (Sup. Ct. Mass. July 20, 1981) (dicta only); *McManus v. Rocky Mountain Federal Savings and Loan Association*, Dkt. 88 No. 494 (Dist. Ct. First Dist. Wyo. 1980).

[9] U.S. CONST., amend. X provides that "The powers not delegated to the United States by the Constitution . . . are reserved to the States respectively. . . ."

language of the Constitution as well as the organic framework of our federal system. As this Court noted in *Usery*:

> Both the States and the United States existed before the Constitution. The people, through that instrument, established a more perfect union by substituting a national government, acting, with ample power, directly upon the citizens, instead of the Confederate government, which acted with powers, greatly restricted, only upon the States. But in many articles of the Constitution the necessary existence of the States, and, within their proper spheres, the independent authority of the States, is distinctly recognized.

426 U.S. at 844, quoting *Lane County v. Oregon*, 74 U.S. (7 Wall.) 71 (1868).

According to the appellants and the Bank Board, the Bank Board has the authority to exempt federal savings and loan associations from *any* state law that adversely affects their "fiscal well being." Appellants' Br. at 18-19; Bank Board's Amicus Br. at 20. Compliance with governmental laws and regulations imposes costs on any business. Therefore, by definition, the Bank Board's preemptive power could reach to any state law without limitation.

The power of a federal agency to alter state policy choices according to their impact on the financial status of a private business entity is the type of "drastic" interference with state sovereignty that this Court struck down in *Usery*. Surely, if state sovereignty and concepts of federalism mean anything, states must be free under the Constitution to adopt laws governing their citizens, and not have those laws subject to amendment by a federal agency acting merely to protect the profitability of an industry that it regulates.

Indeed, there can be no question that federal savings and loan associations presently comply with a vast array of state laws that ultimately could affect their economic performance. For example, state law provides the forum and procedures through which lenders may, if necessary, initiate foreclosure proceedings. These same state laws defining foreclosure procedures also typically define when and under what circumstances a borrower may redeem his rights to the underlying property. The Bank Board apparently claims that Congress gave it the authority under HOLA also to amend state foreclosure and redemption laws from time to time if to do so would improve the "efficiency" of a federal savings and loan association.

Likewise, state contract law generally defines the types of contracts that are valid and enforceable and those types of contracts that are either void, voidable or unenforceable. Corbin, *Contracts*, §§ 6-8 (1962). Typical state law defenses to an action for breach of contract include the statute of limitations, duress, unconscionability, incapacity, or incompetency. These defenses could prove economically detrimental to a federal savings and loan association, and therefore, under the interpretation of HOLA advanced by the Bank Board, the Board has the power to eliminate these defenses in any contract action by a federal savings an loan association.

The interpretation of HOLA urged by appellants and the Bank Board not only permits the Board to reverse sovereign state policies concerning matters of traditional local concern, but it also requires states to enforce two sets of standards among mortgage lenders and borrowers. State savings and loan associations, commercial banks and other financial institutions, as well as non-institutional lenders, are subject to the full panoply of state laws governing mortgages, contracts, real

property, foreclosure, and redemption. *See Dawn Investment Co. v. Superior Court of Los Angeles County*, 30 Cal. 3d 695 (1982). Federal savings and loan associations, however, are required to observe only those state laws that the Bank Board deems appropriate.

Simply put, Congress could not have conferred upon the Bank Board the authority it claims without drastically impairing the rights of states that are recognized by the fabric of the Constitution and the tenth amendment. Federal authority has never previously been exercised in a manner that permits a federal agency to pick and choose those state laws with which a federally chartered business entity must comply depending upon the effect those laws may have on the entity's "fiscal well being." Nor has federal authority ever been used to create separate standards for business entities engaged in precisely the same activity within a single state. Surely, the utter destruction of state sovereignty implicit in the Bank Board's interpretation of HOLA equals the destruction this Court refused to permit in *National League of Cities v. Usery*.

CONCLUSION

Despite the intensity of the controversy surrounding the enforcement of due-on-sale clauses, the controversy remains a matter of contract interpretation which has historically and traditionally been a matter of state law. The Bank Board, however, contends that when the policies of a state on the enforceability of the clause adversely affects the profitability of a federal savings and loan association, the Bank Board has the authority under HOLA to nullify those policies to the extent they apply to a federal association.

Not only would such authority portend the destruction of the various competing financial institutions who must comply with state law, but it would also portend the destruction of state sovereignty to an extent not permitted under the tenth amendment.

For the foregoing reasons, Amicus Curiae National Association of Realtors® submits that the decision of the California Court of Appeal should be affirmed.

Respectfully submitted,

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Dated: March 27, 1982

Appendix

APPENDIX A

UNITED STATES DISTRICT COURT
MIDDLE DISTRICT OF FLORIDA
JACKSONVILLE DIVISION

Case No. 79-859-Civ-J-B

DAULTON W. KIRKLAND and VIRGINIA KIRKLAND, his wife, and CRAIG E. MOORE and REALTY MORTGAGE SERVICES, INC., a Florida corporation,

Plaintiffs,

v.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION OF JACKSONVILLE,

Defendant.

OPINION

Plaintiffs Kirkland (hereinafter "the Kirklands") are prior owners of a certain condominium parcel (hereinafter "the property") subject to a mortgage held by defendant Fidelity Federal Savings and Loan Association of Jacksonville (hereinafter "Fidelity"). Paragraph 17 of the mortgage provides that,

> If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Mortgage . . . Lender may, at Lender's option, declare all sums secured by this Mortgage to be immediately due and payable.

On June 29, 1979, the Kirklands transferred the property to plaintiff Moore, subject to a "wrap-around" mortgage which was subsequently assigned to plaintiff, Realty Mortgage Service, Inc. This "wrap-around" mortgage was inferior to the mortgage held by Fidelity.

On July 1, 1979, and again on August 1, 1979, plaintiffs sent Fidelity a check for $253.58 as payment on the mortgage. Both checks were refused by Fidelity which stated that paragraph 17 of the mortgage had been violated and called the entire balance due. As an alternative, Fidelity suggested that Moore assume the loan "on terms and at an interest rate satisfactory to Fidelity Federal Savings."

On September 10, 1979, plaintiffs filed this action in the Circuit Court for the Fourth Judicial Circuit, in and for Duval County, Florida, seeking declaratory and injunctive relief. They claimed that the "wrap-around" mortgage is a lien or encumbrance subordinate to Fidelity's mortgage, and as such falls within exception (a) to paragraph 17.

On September 28, 1979, defendant filed a Motion to Dismiss and to Strike. On October 1, 1979, it petitioned for removal to this Court. As a basis for removal, defendant alleges that it is a federally chartered savings and loan association subject to regulation by the Federal Home Loan Bank Board (hereinafter "Board"). It claims that the Board has specifically authorized federal savings and loans to include paragraph 17 in their mortgage contracts and has specifically required that such contracts also include exception (a). 12 *C.F.R.* § 545.6-11(f) & (g). Defendant argues that these regulations preempt state law on the subject and, therefore, the complaint raises a question of federal, not state, law.

On November 2, 1979, plaintiffs filed a Motion to Remand arguing that interpretation of paragraph 17 is governed by state law. They further claim that, even if defendant is correct, preemption is a federal defense which will not support removal jurisdiction.

Defendants argue that federal regulation has totally preempted the law in this case and that the Court must look solely to federal law and regulations as it does, for example, in the area of labor law. *See Glaziers, Glassworkers (Local No. 1928) v. Fla. Glass & Mirror*, 409 F. Supp. 225 (M.D.Fla. 1976). Defendant's contention would be correct if plaintiff were challenging the validity or interpretation of the federal regulations. Further, if the state were attempting to place additional regulations on a federally chartered savings and loan, it would be precluded from doing so by federal preemption. This is the import of the cases cited by defendant, *Kupiec v. Republic Federal Savings and Loan Association*, 512 F.2d 147 (7th Cir. 1975); *Murphy v. Colonial Federal Savings and Loan Association*, 388 F.2d 609 (2d Cir. 1967). *Meyers v. Beverly Hills Savings and Loan Association*, 499 F.2d 1145 (9th Cir. 1979), as well as that of the Board's statement on publication of the regulations:

> [I]t was and is the Board's intent to have late charges and due on sale practices of Federal associations governed exclusively by Federal law. Therefore, charging of late charges and exercise of due on sale clauses by Federal associations shall be governed and controlled solely by § 545.6-11 and the Board's new Statement of Policy. Federal associations shall not be bound by or subject to any conflicting state law . . . .

41 Fed. Reg. 18287 (May 3, 1976).

However, plaintiffs in this case raise an entirely different question. They do not challenge the validity of

the "due on sale" clause nor request an interpretation of the federal regulation. Nor is this a case in which the state is attempting to regulate the practices of a federal association. Plaintiffs instead ask only for an interpretation of the mortgage contract. They raise questions governed by contract and real property law. The law of real estate mortgages has not been totally preempted by federal law even though the mortgage is issued by a federally chartered lending institution. In fact, most mortgage foreclosures are appropriately brought in state courts, and even when brought in federal court generally are governed by state law. *See Federal National Mortgage Association v. Kostrunek*, 228 F. Supp. 777 (W.D.Iowa 1964) (Methods of foreclosure and rights of redemption governed by Iowa law).

Even though federal law has not preempted the entire field, in light of the almost verbatim adoption of the federal regulation as a provision of the contract, it is possible that state law on this particular point may have been preempted by implication. Though federal preemption may sometimes be implied, the implication should be accepted only where the intention is clearly manifest. *See Schwartz v. Texas*, 344 U.S. 199 (1952). This is particularly true in the area of rights to real property which traditionally has been left to the states. *See La. Power & Light Co. v. City of Thibodaux*, 360 U.S. 25 (1959); *Kaiser Steel Corp. v. W. S. Ranch Co.*, 391 U.S. 593 (1968).

No such congressional, or even regulatory, intent is manifest in this case. The regulation permitting the clause in question was prompted by a desire to protect the federal association's interest in the property and should be construed with that in mind. *See Advisory Opinion of the Federal Home Loan Bank Board*, Resolution No. 75-647 (July 30, 1975); *Conference of Federal*

Savings and Loan Associations v. Silberman, Civ. No. S 78-55-PCW (E.D.Cal. 1979); *Nalore v. San Diego Federal Savings and Loan Assn.*, Civ. No. 77-0600-N (S.D.Cal. 1979). Given the predominance of state law in the field of real property, this goal can only be reached by construing the clause under state law.[1] The effect of a "wrap-around" mortgage may vary from state to state. Therefore, its effect on the lender's interest in the property may also vary among states. Thus, in one state the right to call a mortgage due upon exercise of a subsequent wrap-around mortgage may be necessary to protect the association's interest in the property, while under the laws of another state the interests of the parties may be so defined as to make such a right unnecessary. Therefore, paragraph 17 will and should be construed differently under the laws of the various states.

Further, the document itself reflects an understanding between the parties that the case be governed by state law. Paragraph 15 reads, "This mortgage shall be governed by the law of the jurisdiction in which the property is located." Even if this were not the case, the Court would almost be forced to look to state law. There is no federal law governing the interpretation of mortgages. Defendant's position would require the Court

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[1] There are many situations in which state law is adopted by or impacts federal law, particularly in areas of traditional state interest. *E.g.*, *De Sylva v. Ballentine*, 351 U.S. 570 (1956) (definition of term "children" in copyright law governed by state law); *R.F.C. v. Beaver County*, 328 U.S. 204 (1946) (definition of real property for purposes of federal tax exemption governed by state law). Other examples include the Federal Torts Claims Act, 28 U.S.C. § 1346(6), (cause of action created by state law) and federal bankruptcy. *Matter of Gervich*, 570 F.2d 247, 251 (8th Cir. 1978) (state law determines the extent of the bankrupt's interest in property).

to fashion an entire body of federal law to govern real estate mortgages, which the Court is unwilling to undertake without explicit congressional direction. The mere delegation of rule-making authority does not constitute such a direction.

Therefore, the Court will this day enter an order remanding this case to the state court.

ISSUED at Jacksonville, Florida, this 16 day of May, 1980.

/s/ Susan H. Black
United States District Judge

[Mailing list and certification of Deputy Clerk omitted in printing.]

APPENDIX B

FNMA/FHLMC UNIFORM INSTRUMENT
(In Pertinent Part)

MORTGAGE

THIS MORTGAGE is made this ..... day of ....., 19 ....., between the Mortgagor, ... (herein "Borrower"), and the Mortgagee, ..., a corporation organized and existing under the laws of ....., whose address is ..... (herein "Lender").

WHEREAS, Borrower is indebted to Lender in the principal sum of ..... Dollars, which indebtedness is evidenced by Borrower's note dated .... (herein "Note"), providing for monthly installments of principal and interest, with the balance of the indebtedness, if not sooner paid, due and payable on .....;

TO SECURE to Lender (a) the repayment of the indebtedness evidenced by the Note, with interest thereon, the payment of all other sums, with interest thereon, advanced in accordance herewith to protect the security of this Mortgage, and the performance of the covenants and agreements of Borrower herein contained, and (b) the repayment of any future advances, with interest thereon, made to Borrower by Lender pursuant to paragraph 21 hereof (herein "Future Advances"), Borrower does hereby mortgage, grant and convey to Lender the following described property located in the County of ....., State of ..... .

which has the address of .....,.....,
[Street] [City]

..... (herein "Property Address");
[State and Zip Code]

TOGETHER with all the improvements now or hereafter erected on the property, and all easements, rights, appurtenances, rents, royalties, mineral, oil and gas rights and profits, water, water rights, and water stock, and all fixtures now or hereafter attached to the property, all of which, including replacements and additions thereto, shall be deemed to be and remain a part of the property covered by this Mortgage; and all of the foregoing, together with said property (or the leasehold estate if this Mortgage is on a leasehold) are herein referred to as the "Property".

Borrower covenants that Borrower is lawfully seised of the estate hereby conveyed and has the right to mortgage, grant and convey the Property, that the Property is unencumbered, and that Borrower will warrant and defend generally the title to the Property against all claims and demands, subject to any declarations, easements or restrictions listed in a schedule of exceptions to coverage in any title insurance policy insuring Lender's interest in the Property.

* * * * *

Amicus Brief

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Supreme Court, U.S.
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MAR 27 1982
ALEXANDER L. STEVAS
CLERK

No. 81-750

IN THE

Supreme Court of The United States

OCTOBER TERM, 1981

Fidelity Federal Savings and Loan Association, et al.,
Appellants,

vs.

REGINALD D. DE LA CUESTA, et al.,
Appellees.

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,
Appellants,

vs.

ALPHONSO MOORE, et al.,
Appellees,

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, et al.,
Appellants,

vs.

JOHN D. WHITCOMBE,
Appellee.

ON APPEAL FROM THE CALIFORNIA COURT OF APPEAL, FOURTH APPELLANT DISTRICT.

AMICUS CURIAE BRIEF OF THE SECRETARY OF THE BUSINESS, TRANSPORTATION AND HOUSING AGENCY OF THE STATE OF CALIFORNIA IN SUPPORT OF THE APPELLEES

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QUESTIONS PRESENTED

1. May preemption be found when the federal agency's regulations are permissive and not in conflict with state law?
2. Is the Federal Home Loan Bank Board's statement of intent to preempt sufficient to create preemption when the regulations in question were not promulgated in accordance with the Administrative Procedures Act?
3. When the application of state law does not interfere with the protection of the security interest of the lender, can preemption be found?
4. May preemption be found when the alleged economic impact of restricting the use of the due-on-sale clause is not supported by the record?

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No. 81-750

In The Supreme Court Of The United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL.,

Appellants,

vs.

REGINALD D. DE LA CUESTA, ET AL.,

Appellees,

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL.,

Appellants,

vs.

ALPHONSO MOORE, ET AL.,

Appellees,

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL.,

Appellants,

vs.

JOHN D. WHITCOME,

Appellees,

On Appeal from the California Court of Appeal,
Fourth Appellant District

AMICUS CURIAE BRIEF OF THE SECRETARY OF THE BUSINESS, TRANSPORTATION AND HOUSING AGENCY OF THE STATE OF CALIFORNIA IN SUPPORT OF APPELLEES

INTEREST OF AMICUS CURIAE.

The Secretary of the Business, Transportation and Housing Agency of the State of California ("Secretary" or "Amicus") files this Amicus Curiae brief in support of the Appellees in the within consolidated cases.

The Secretary has in this and other related cases in which she is a party, opposed the notion that lending institutions making loans in California, secured by California real estate and utilizing California corporations as trustees, are somehow immune from state real property and debtor protection laws, just because the institution happens to have a federal charter.

The Secretary is particularly concerned with the adverse effects that preemption would have on California. First, it is basically unfair because borrowers have not known that they would have fewer rights when they borrowed from a federally chartered association rather than from a state association. Second, state associations are converting to federal associations simply to escape the application of state laws, thus jeopardizing California's role with respect to financial institutions in this state. Third, federally chartered associations should not have an advantage over state chartered associations by being able to pick and choose which portions of state law bind them while eschewing those portions they don't like. This is especially so in view of the fact that state law expressly grants to federal associations "all rights, powers, and privileges . . . [and] exemptions and immunities" granted to state chartered associations. (Cal. Fin. Code § 11000.) Fourth, if federally chartered associations are immune from the state laws involved in this case, then they may be immune from other state laws relating to their

lending activities and perhaps from other state laws such as zoning, health and safety and even criminal laws.[1] Fifth, the Federal Home Loan Bank Board ("Board") a non-elected federal administrative agency should not be able to cause unpredictability and confusion by suddenly purporting to nullify historic state real property and contract laws. Sixth, federally chartered associations should not be able to take advantage of certain state laws concerning their real property transactions and even provide in their lending instruments for the application of state laws, while avoiding the application of some state laws.

For all of the foregoing reasons, the Secretary has an interest in the subject matter of this action.

INTRODUCTION

The Secretary is aware that a substantial number of briefs are being filed with the court which discuss the factors which must be analyzed in determining whether California's equitable restriction on the exercise of the due-on-sale clause has been preempted by the Home Owners Loan Act of 1933 ("HOLA") (49 Stat. 128 (1933), 12 U.S.C. 1463 *et seq.*) These factors include:

1. The absence of express language of preemption in the statute;

2. The expressed reluctance of this court to declare preemption when to do so would require displacement of matters of purely local concern, i.e., laws regulating real property transactions and contract interpretation;

3. The existence of a legislative history which demonstrates that Congress in enacting HOLA did not intend to displace local real property and contract law; and,

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[1] There are many state laws which unquestionably apply to federally chartered institutions. These would include health, safety and wage laws, as well as various real property laws (e.g. antideficiency laws). These laws apply to all employers and institutions doing business in California, including those that are federally-chartered. These laws do not "regulate" the federal association.

4. The deeds of trust in dispute refer to and incorporate by reference California law.

See, generally Amici Curiae Brief of the State of Michigan, et al.; Brief of Charles J. Bether and Edna M. Bether as Amicus Curiae; Amicus Curiae Brief of the California Association of Realtors; and Amicus Curiae Brief of the Secretary of the California Business, Transportation and Housing Agency in Support of Motion to Dismiss or Affirm. Because of the extensive briefing submitted by the above listed amici the Secretary in this brief will focus on:

1. The purported preemptive effect of the Board's regulations; and

2. The economic impact of applying the California due-on-sale limitation to federal savings and loan associations.

SUMMARY OF ARGUMENT

1. Even if the Federal Home Loan Bank Board ("Board") intended by promulgation of its regulations to preempt state law it did not succeed in doing so because, *inter alia,* the regulations do not conflict with state law and the Board's statement of intent is not a substantive rule and, therefore, does not have the force of law.

2. Application of state law does not frustrate the Congressional purpose of providing lenders with adequate security for their loans.

3. The operation of state law does not prevent federal savings and loan associations from operating profitably and, therefore, does not interfere with their ability to perform any of the functions assigned them by Congress.

ARGUMENT

I

BOARD REGULATIONS DO NOT AND CANNOT PREEMPT

Effective July 31, 1976, the Board issued regulations (12 C.F.R. 545.6-11)[2] (the "due-on-sale regulations" or "regulations") dealing with due-on-sale clauses. The Board stated in an introductory comment to the regulations that they were intended to preempt all state laws in the area. (41 Fed. Reg. 18287 (1976)). The comment is not part of the regulations and was not enacted pursuant to the Administrative Procedure Act ("APA"). As will be pointed out *infra*, the Board's self-serving statement can have no legally significant effect.

The regulations themselves provide in pertinent part:

> "(f) *Due-on-sale Clauses.* A Federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. Except as provided in paragraph (g) of this section with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by an association of such an acceleration option (hereafter called a due-on-sale clause) shall be governed exclusively by the terms of the contract between the association and the borrower, and all rights and remedies of the association and borrower thereto shall be fixed and governed by said contract."

Paragraph (g) then prohibits the exercise of the clause for loans made after July 31, 1976, on the security of a one-to-four unit dwelling occupied by the borrower, as follows:

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[2] Recodified as 12 C.R.F. 545.8-3(f) and (g).

"Federal associations may not exercise a due-on-sale clause based on any of the following:

"(i) creation of a lien or other encumbrance subordinate to the associations' security instrument;

"(ii) creation of a purchase money security interest for household appliance;

"(iii) transfer by devise, descent, or by operation of law upon the death of a joint tenant; or

"(iv) grant of any leasehold interest of three years or less not containing an option to purchase."

The Board's amendment to 12 C.R.F. 545.6-11 provides that lenders *may* accelerate mortgages if there is a transfer of an interest in the real property securing the loan. But significantly, the Board does *not require* federal associations to utilize or enforce due-on-sale clauses.

A. The Board Did Not Preempt

The Board regulations themselves do not conflict with state law. They do not require any association to accelerate a loan. Rather, they merely restrict the exercise of the clause in certain limited circumstances, but otherwise make the acceleration of loans a matter of contract between the borrower and lender. California law, on the other hand, protects borrowers by providing them with state law defenses to arbitary and capricious accelerations by lenders. (*See, e.g.,* Cal. Civ. Code §2924.6; *Wellenkamp* v. *Bank of America* (1978) 21 Cal. 3d 943; *Tucker* v. *Lassen Savings and Loan Association* (1974) 12 Cal. 3d 629.) Thus, the two regulatory schemes are not in conflict.

The regulations' statement that the rights of borrowers are to be governed by the "terms of the contract" between the borrowers and the association, could not mean that contractual terms which are illegal under state law are nonetheless enforceable. Where as here, the federal and state regulatory schemes can be read to be compatible, this Court has stated that, "The proper approach is to reconcile the operation of both statutory schemes with one another rather than holding one completely

ousted." (*Merrill Lynch, Pierce, Fenner & Smith* v. *Ware,* (1973) 414 U.S. 117, 127.)

California law is also consistent with the purposes of the federal scheme of home loan regulation. One of the purposes of HOLA was to provide relief to home owners with respect to home mortgage indebtendess by discouraging unjustified foreclosures. (*See* 12 U.S.C. §1464 (a); preamble to HOLA, 48 Stat. 128 (1933).) In establishing the Board, Congress gave it explicit instructions to give "primary consideration to the best practices of local mutual thrift and home financing institutions . . . ." (12 U.S.C. §1464(a).) California law, by reasonably limiting the circumstances under which due-on-sale clauses can be exercised, provides relief to home owners and buyers, discourage unjustified mortgage foreclosures, and embodies the fair local practices which are supposed to guide the Board's regulation of federal associations.

B. The Introductory Statement In The Board Regulations Is Not Applicable

The Board regulations, which by their own terms are inapplicable to instruments executed prior thereto, contain no language of preemption. Only an introductory statement in a resolution (41 Fed. Reg. 18287 (1976)) (not the regulation) and a later published "Statement of Policy" (12 C.F.R. §556.9(f)) purports to preclude state regulation. However, neither the introductory statement nor the statement of policy have the force of law, for neither constitutes a "substantive rule — or a 'legislative-type rule' . . . 'affecting individual rights and obligations' " (*See Chrysler Corp.* v. *Brown* (1979) 441 U.S. 281.)

That it is inapplicable is clear from the fact that it was not enacted in the way the regulations were enacted — *i.e.,* pursuant to procedural requirements. The statement was not published in the first publication of the proposed regulation (41 Fed. Reg. 6283-87) as required by the APA, 5 U.S.C. § 552(b)(3)(c), and was never incorporated into the body of the regulation. Certainly purporting to preempt state law and thereby depriving borrowers of state law defenses is a substantive regulation

which must be published. (*See, e.g., Hou Ching* v. *Attorney General* (D.D.C. 1973) 362 F. Supp. 1288, 1292.)

Thus, the Board's introductory statement was obviously not intended to constitute substantive law because it was not enacted in accordance with the APA, 5 U.S.C. § 553. Section 553 expressly requires notice, including publication in the Federal Register, and an opportunity to be heard, including the opportunity to submit written data, views and arguments. It is unquestioned that there was no compliance with these mandatory procedures.

Nor can it be contended that the statement comes within an exception to the applicability of the APA. The only arguable exception is 5 U.S.C. § 553(b)(a), pertaining to "interpretive rules, general statements of policy, or rules of agency organization, procedure or practice. . . ." Although the Board purports to be engaging in clarification, this court is not bound by the label the Board puts on its pronouncements. (*Saint Francis Memorial Hospital* v. *Weinberger* (N.D. Cal. 1976) 413 F. Supp. 323, 327, citing *Columbia Broadcasting System Inc.* v. *United States* (1942) 316 U.S. 407.) As the *Saint Francis* court pointed out, whether a rule is in fact interpretive is judged from the practical standpoint of the impact of the proposed rule on the existing legal structure. (413 F. Supp. at 328.)

Similarly, 12 C.F.R. § 556.9(f), the Board's Statement of Policy proclaimed it to be the Board's policy that the substantive due-on-sale regulations are "in preemption of and without regard to any limitations imposed by state law. . . ." This Statement of Policy, like the introductory comment, is by definition not a substantive rule of law and cannot have and does not have any preemptive effect.

This Court in *Chrysler Corporation* v. *Brown* (1979) 441 U.S. 281 recently discussed the issue at great length and concluded:

> "We need not decide whether these regulations are properly characterized 'interpretative rules.' It is enough that such regulations are not properly promulgated as substantive rules, and therefore not the product of procedures which Congress prescribed as necessary prerequisites to giving a

regulation the binding effect of law. *An interpretative regulation or general statement of agency policy cannot be the 'authoriz[ation] by law' required by § 1905." Id* at 315-316 (footnotes omitted)(emphasis added).

Thus, the Board's interpretative provisions claiming preemption cannot have the force of law. That the board found it necessary during litigation to which it was a party to make the introductory statement and the statement of policy suggests that there was no other basis for preemption.

C. Even If the Board Purported To Preempt in This Case, It Could Not Validly Do So

Even if the Board's introductory statement, including the preemption language, were enacted as substantive regulation and in fact conflicted with state law, such preemption by regulation was not authorized by Congress.

It is "the intent of Congress" that determines whether there is preemption. *(Malone* v. *White Motor Corp.,* (1978) 435 U.S. 497.) Professor John Hetland has referred to the Board's efforts to preempt by regulation as "a doubtful premise in view of the scope of preemption permissible under the powers delegated to it by Congress." (J. Hetland, Secured Real Property Transactions (Cont. Ed. Bar 1977) p. 32; *see* Hirsh, *Towards a New View of Federal Preemption,* 1972 Univ. of Ill. L. Forum, 515, 551. ("Only rarely does the Supreme Court respect clear expressions of agency intent to supersede or to preserve state laws."))

In holding that regulation was not authorized, this Court recently stated in *Chrysler Corporation* v. *Brown, supra:*

> "That an agency regulation is 'substantive,' however, does not by itself give it the 'force and effect by law.' The legislative power of the United States is vested in the Congress, and the exercise of quasi-legislative authority by governmental departments and agencies must be rooted in a grant of such power by the Congress and subject to limitations which that body imposes." (441 U.S. 302) (The legislative history of HOLA is fully presented in the Amici Curiae Briefs of the

State of Michigan, et al., and of Charles J. Bether and Edna M. Bether.)

It should be noted that a Congressional Committee referred to the Board's rulings that federal savings and loan associations do not have to comply with state laws "even in those cases where the state law affords the borrower with a greater degree of protection." (S.Rep. No. 93-902, 93rd Cong., 2d Sess. 12 (1974), reprinted in 1974 U.S. Code Cong. & Ad. News 6119, 6130.) The Committee then stated:

"During the Committee's consideration of this issue, some doubt was expressed that the Bank Board has the authority to preempt state law by regulation. . . ."

"Unless there are overriding interests to the contrary, the federal government should not interfere with the efforts of a State to protect consumers. Federally chartered financial institutions are subject to a wide variety of State laws including laws dealing with taxes, branching, fire and building codes, conversions, usury and the like. The Committee sees no reason to make a special exception for consumer protection laws. . . ."

"Even if a case could be made for preempting a State consumer protection law in a particular area, the power to reverse the judgment of a State should not be delegated to a federal administrative agency. The Comptoller of the Currency and the National Credit Union Administration are headed by one man, while the Federal Home Loan Bank Board is headed by three. These non-elected officials should not be given the power to overrule by a stroke of the pen, the considered judgment of a State Legislature and its governor. Only Congress should make such a decision if it is to be made at all. . . ."

"If federally chartered financial institutions are exempted from State consumer protection laws, these institutions would be given an unfair competitive advantage over State chartered financial institutions. If State chartered institutions are able to live under State consumer protections laws,

there is no reason why federally chartered institutions should not abide by the same rules."

Finally, it must be asked whether the Board, by regulation, can simply eliminate certain property and procedural rights given to California property owners. The decisions rendered by the California Supreme Court in *Tucker* v. *Lassen Savings and Loan Association,* (1974) 12 Cal.3d 629, and *Wellenkamp* v. *Bank of America,* (1978) 21 Cal.3d 943, require that before a lender in a loan assumption situation may invoke the provisions of California real property law allowing foreclosure of a deed of trust, the lender must make a finding that there has been an impairment of security or the property has been subjected to waste. The method of exercise of the due-on-sale clause utilized by the federal association herein is the summary termination of a recorded interest in real property upon the occurrence of a transfer of the real property, without regard for the rights of the borrowers as provided under California real property law. Surely the Board should not be able simply to take away from borrowers certain vested property rights and to permit foreclosures without the findings required by state law.

The Ninth Circuit Court of Appeals stated in *Geneva Towers Tenants Organization* v. *Federated Mortgage Investors,* (9th Cir. 1974) 504 F.2d 483, 488:

> "The Supreme Court, in *Goldberg* v. *Kelley,* 397 U.S. 254, 90 S.Ct. 1011, 25 L.Ed.2d 287 (1970), enunciated a two-step process for analyzing cases involving the deprivation of a governmental benefit. First, it must be ascertained whether the interest at issue is a constitutionally protected 'property' or 'liberty' interest. *See, id.* at 262, 90 S.Ct. 1011. Second, if the interest is a protected one, the beneficiary's interest in avoiding loss must be balanced against the government's interest in summary adjudication. *Id.* at 262-266, 90 S.Ct. 1011. *See generally* Note, *supra,* 86 Harv.L.Rev. 899." (Footnotes omitted.)

Once a state decides to grant property rights or privileges to its citizens, due process safeguards attach to those rights and privileges. *(Smith* v. *McGriff,* (M.D. Ala. 1976) 434 F.Supp. 673, 680.)

> "Property interests, of course, are not created by the Constitution. Rather, they are created and their dimensions are defined by existing rules or understandings that stem from an independent source such as state law — rules or understandings that secure certain benefits and that support claims of entitlement to those benefits . . . ." *(Board of Regents* v. *Roth,* (1972) 408 U.S. 564, 577 (emphasis added).)

Since the due process constraints apply to the actions of the federal government *(Mathews* v. *Eldridge,* (1976) 424 U.S. 319, 323), by what right does the Board purport to eliminate property rights of California citizens? Amicus suggests the Board has no such right.

II
APPLICATION OF STATE LAW DOES NOT FRUSTRATE THE CONGRESSIONAL PURPOSE OF PROTECTING THE SECURITY INTEREST OF THE LENDER

The Bank Board has had in effect since 1948, a regulation requiring federal associations to use lending instruments which provide "full protection" of property used as security for loans. (See 12 C.F.R. 545.8-3(a).) Amicus curiae readily agrees with appellants that there exists a need for protecting the security relied upon by federal lenders in making loans. This protection however, is now afforded federal savings and loans by application of California law.

In promulgating the July 1976 regulations, the Board justified federal preemption of the exercise of the due-on-sale clause on the theory that "the authority of Federal associations has been the subject of controversy and litigation in certain states" (41 Fed. Reg. 6285, February 12, 1976), and the Board wished to avoid the possibility that a state court or legislature might

invalidate the use of the clause. Elsewhere in the same publication, the Board refers to the "elimination" of the due-on-sale clause. Similarly, the Board in an Advisory Opinion[3] justified preemption by arguing that "elimination" of the clause would unduly injure federal associations. The Board however created a straw man which posed a nonexistent threat.

No state court has invalidated the clause and no state legislature has eliminated its use. See, Anno., Validity, Construction and Application to Clause Entitling Mortgagee to Acceleration of Balance Due in Case of Conveyance or Transfer of Mortgaged Property, 69 ALR 3d 713 (1976). Nor is it likely that any state would eliminate the clause, since the states, just like the federal government, take an interest in protecting the housing industry and in promoting home ownership, and neither of these interests would be served by scaring mortgagees out of business by depriving them of a useful device for protecting the security of their loans.

Indeed, the state law here in question, California Civil Code Section 711, as interpreted in *Wellenkamp* v. *Bank of America* (1978) 21 Cal.3d 943, provides only that a lender may not *automatically* accellerate a loan when there has been a transfer of the real property security. Rather, the lender is required to look at the facts of each specific case and determine whether the transfer has resulted in an impairment of its security. If such is found to be the case then the lender may exercise the due-on-sale clause in order to protect its ligitimate concerns. Certainly application of this law provides "full protection" of the lender's security and cannot justify preemption by the Board.

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[3] The self serving Advisory Opinion was prepared by the Board in response to the request of the court in the case of Schott v. Mission Federal Savings & Loan Association, No. Civ.-75-366 (C.D. Cal., July 10, 1975.)

III

THE "FACTS" ASSERTED BY APPELLANTS AND THEIR AMICI WITH REGARDS TO THE ECONOMIC IMPACT OF RESTRICTING USE OF THE DUE-ON-SALE CLAUSE ARE NOT SUPPORTED BY THE RECORD

In determining whether there is preemption in this case, the Court must look at the two regulatory schemes "as they are interpreted and applied, not merely as they are written". (*Jones* v. *Rath Packing Company, et al.*, (1977) 430 U.S. 519, 526.)

This, of course, requires a factual inquiry. Appellants and various amici supporting appellants have urged that it is crucial to the economic well-being of federal savings and loan associations that they be able to exercise the due-on-sale clause without regard to state laws of equity, real property or contract. However, the instant cases were decided without a trial and as a consequence no factual findings were made by the trial court on the economic issues. Because of the dearth of evidence in the record, appellants and their amici have gone outside the record and in support of their unfounded contentions, cite a self-serving "study" prepared by an industry oriented task force [4]. In contrast to this are the findings in the only case in the nation in which a full trial on the merits was conducted, where the trial court found that the effect of the California restrictions on the due-on-sale clause would have an "insignificant effect" on the ability of the federal assocations to perform any functions assigned to them by Congress. [5] (See Appendix, pp. 5-7, findings 23-39.) State law could only be preempted if it incapacitates the federal associations

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[4] The task force study submitted by the Bank Board was prepared by a group of savings and loan executives and Bank Board economists. Many of these associations and the Bank Board itself are parties to litigation on the due-on-sale clause. The bias of this conclusionary report is self-evident.

[5] *People, etc.* v. *Glendale Federal Savings and Loan Association, Pet. for Cert. Pending, Docket No. 81-1503 (U.S., January 26, 1982).*

from performing their duties. *(See, McClellan* v. *Chipman* (1896) 164 U.S. 347, 356-57, 359; *Anderson Nat'l Bank* v. *Tuckett* (1944) 321 U.S. 233, 247-48; *First National Bank of Louisville* v. *Commonwealth of Kentucky* (1870) 76 U.S. (9 Wall) 353, 362 (1870).) As discussed below this is clearly not the case in the present matter.

Traditionally, a lender used the due-on-sale clause to protect its security interest in the property; thus under the rule issued by the California Supreme Court in *Wellenkamp* v. *Bank of America* (1978) 21 Cal.3d 943, a lender may exercise the due-on-sale clause if the transfer would result in an impairment of the lender's security or subject the property to waste. However, apart from any legal restrictions on the exercise of due-on-sale clauses there are several economic factors involved in a lender's determination of whether to accelerate a loan. For example, in a market in which the interest rate of the loan equals or exceeds prevailing rates at the time of the transfer, a lender will not want to exercise the clause, but instead will want to permit the existing loan to remain in place and for the new purchaser to assume the loan. Similarly, with respect to variable interest rate loans a lender will have less incentive to accelerate because these loans track changing interest rates.[6]

Moreover, regardless of whether a lender may wish to exercise a due-on-sale clause, a seller and/or purchaser of the property may *not* wish to have the new purchaser assume the mortgage. In such an event, the loan would be paid off at the time of the transfer. That is to say the lender cannot exercise the due-on-sale clause in the absence of the simultaneous occurrence of a set of special circumstance, i.e.:

(1) there must be a seller willing to permit the assumption,

(2) there must be a buyer who is (A) willing to assume and (B) able to assume by,

(i) paying cash to the loan or,

(ii) arranging for secondary financing.

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[6] *See* 12 C.F.R. 545.6-4(c)(3).

From a borrower's perspective, factors such as current market interest rates compared to the interest rate on the existing loan and the balance on the existing loan in comparison to the value of the property affect the decision to assume. The net result of any loan assumption must provide a more attractive interest rate to the purchaser than would be the case if a new loan is taken out to finance the entire purchase. Housing prices have risen dramatically in recent years. If the existing loan represents a minor portion of the value of the house either an extremely large cash down payment must be made or additional financing must be obtained. This financing can take the form of either a regular second mortgage or a "wraparound" mortgage, i.e., an all inclusive note and deed of trust. In many cases, the added cost of this additional financing will eliminate any financial incentive for a purchaser to assume a loan.[7]

Absent the concurrence of economic circumstances making it beneficial to both the seller and purchaser for there to be a loan assumption, the appellants and their amici's economic contentions concerning impact of restraint of the exercise of the due-on-sale clause are irrelevant. This is so because even if the federal associations were governed exclusively by the board's regulations, they would not have the opportunity to exercise the due-on-sale clause absent these circumstances.

It is the requirement that there be a simultaneous occurance of all the above factors which highlights the conclusionary and

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[7] However, a federal savings and loan association may also make "wraparound" loans. (12 C.F.R. 541.14, Opinion, Office of General Counsel of the Federal Home Loan Bank Board, Oct. 22, 1971.) Many lenders prefer to use "wraparound" financing because this normally results in a higher yield, especially if a federal savings and loan is able to "wraparound" the original loan and charge "points" and loan origination fees on the secondary financing by wrapping around its own loan. By utilizing this process the lender may achieve the economic effect of boosting the overall interest rate on the existing first loan thereby achieving its economic goals without violating equitable due-on-sale limitations.

economically unsound nature of the arguments made by appellants and their amici with regard to the effect of placing equitable limitations on the exercise of the due-on-sale clause. That the savings and loan industry may now be encountering temporary economic problems is undoubted. These temporary problems cannot, however, be attributed to restricting use of the due-on-sale clause; rather they are the result of general economic conditions. The trial court's findings in *People, etc.* v. *Glendale Federal Savings and Loan Association, Pet. for Cert. Pending* Docket No. 81-1503 (U.S. January 26, 1982) support the conclusion that the California limitation on the use of the due-on-sale clause has had an insignificant economic impact. (See Appendix, pp 5-7, Findings 23-39.)

In contrast to the statistically random event giving rise to the opportunity to exercise the due-on-sale clause, there are other events within the direct control of a federal association by which it may increase the interest yield on its loan portfolio and thus increase profits. For example, a lender may sell an existing mortgage on the "secondary mortgage market."[8] Utilization of the secondary market enables a lender to convert the loan to cash which it then relends at the prevailing interest rate.

Further, federal savings and loans can and do make variable interest rate loans; this device permits the lenders to raise the interest rate on existing loans when there is an increase in a "cost of funds" index.[9] (12 C.F.R. §545.6-4(c).)

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[8] At least two federal agencies provide this service (see 12 U.S.C. 1701 and 15 U.S.C. 1457). Additionally, there is a "private market," largely made up of insurance companies and other savings and loans which also purchase mortgages in the "secondary market." Lenders may also issue mortgage backed bonds and use existing, low interest loans as security for the bonds, as well as sell "pass-through certificates". When the "pass-through" device is used, the originating savings and loan sells the mortgage but is still paid a fee for servicing the loan.

[9] It has been argued by the American Savings & Loan League in its Amicus Brief (pp.4-11) that application of state due-on-sale laws to

The lender may also borrow funds from the Federal Home Loan Bank which it can then relend at a higher rate.

In short, appelants' arguments simply make no sense and are contrary to the facts. See Appendix, pp. 5-7, findings 23-39. The impact on the operation of federal associations by enforcing state law restrictions on the exercise of the due-on-sale clause is minimal. By application of California law the security interest of the lender will be protected. Under such circumstances it must be concluded that the application of state law to a federal savings and loan association will not frustrate the Congressional desire in enacting the Home Owner Loan Act of 1933 that relief for home owners be promoted.[10] Thus following the teachings of *Jones* v. *Rath Packing Co., supra* (1977) 430 U.S. 519, 526, the California laws regulating the exercise of due-on-sale clauses cannot be held to have been preempted.

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loans made by federal associations is discriminatory because state licensed associations, which are also subject to the *Wellenkamp* rule, have in the past been able to make variable interest rate loans while federal associations have not. However, as noted, federal associations do have the authority to make variable interest rate loans. With all the devices available to raise cash, it cannot be reasonably or responsibly argued that California law discriminates against the federal associations or prevents them from making loans or frustrates their ability to comply with the requirements of the Community Reinvestment Act (12 U.S.C. §§ 2901, et seq.) or the Equal Credit Opportunity Act (15 U.S.C. §§ 1691, et seq.).

[10] It is ironic that in 1982 appellant and its amicus are urging that the due-on-sale clause may be used to foreclose on home owners thereby defeating the intent of Congress in 1933 when it enacted HOLA to provide relief to home owners.

CONCLUSION

For all the foregoing reasons, the Secretary urges the Court to affirm the decisions of the Court of Appeal.

Respectively submitted,

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Appendix

SUPERIOR COURT OF THE
STATE OF CALIFORNIA FOR THE
COUNTY OF LOS ANGELES

THE PEOPLE OF THE STATE OF CALIFORNIA BY AND THROUGH THE ATTORNEY GENERAL AND THE SECRETARY OF THE BUSINESS AND TRANSPORTATION AGENCY OF THE STATE OF CALIFORNIA.

Plaintiff,

v.

GLENDALE FEDERAL SAVINGS AND LOAN ASSOCIATION, ET AL.,

Defendants,

FEDERAL HOME LOAN BANK BOARD,

Intervenor.

No. C 147 921

FINDINGS OF FACT AND CONCLUSIONS OF LAW

Department: 42

The above-entitled action came on regularly for trial on July 26, 30 and 31, August 1, 2, 7, 8 and 9, 1979, in Department 42 of this court, honorable Jack T. Ryburn presiding. Plaintiff, the People of the State of California (the "People"), was represented by Attorney General George Deukmejian, by Deputy Attorney General Joseph M. O'Heron, and by Richard M. Mosk, Esq. and W. Gary Kurtz, Esq. Defendant Glendale Federal Savings and Loan Association ("Glendale") was represented by McKenna & Fitting, by William McKenna, Esq., G. Howden Fraser, Esq., Terry O. Kelly, Esq., and Daniel Willick, Esq. Intervenor, the

Federal Home Loan Bank Board (the "Board") was represented by Jonathan Heffron, Esq. The oral and documentary evidence of the parties was duly received and considered, and the parties were duly heard. On July 30, 1979, the court entered an order that plaintiff was collaterally estopped as to certain of its claims by the judgment in Glendale Federal Savings and Loan Association v. Fox, United States District Court, Central District of California, Case No. 77-3274 WMB. On August 10, 1979, the court entered an order granting plaintiff's motion for judgment pursuant to Code Civ. Proc. § 631.8 as to the balance of its claims then remaining in the action.

NOW, THEREFORE, the court makes the following findings of fact and conclusions of law.

FINDINGS OF FACT

1. Plaintiff, the People of the State of California, has brought this action by and through the Attorney General and the Secretary of the Business and Transportation Agency of the State of California.

2. Glendale is now, and at all times relevant has been, a federally-chartered savings and loan association with its principal office located in Glendale, California.

3. Intervenor Board is an independent agency of the United States.

4. The Board voluntarily intervened in this case while the case was in the United States District Court.

5. The Board opposed on the merits a motion by plaintiff for summary judgment herein.

6. Plaintiff brought this action to enforce California law and to protect California-chartered financial institutions.

7. Glendale is a federally-chartered association organized and existing under and by virtue of the Home Owners Loan Act of 1933, 12 U.S.C. § 1461, et seq, ("HOLA").

8. In all pertinent respects, Glendale is representative of federally-chartered savings and loan associations in California ("federal associations").

9. All of Glendale's offices and branches are located in the State of California.

10. Glendale engages in the business, inter alia, of making loans to individuals to finance the purchase of residences and commercial property, which property is generally located in California.

11. Glendale itself, and through wholly-owned subisidiaries organized pursuant to California Law, engages in other businesses, including mortgage lending, in California.

12. At all times relevant, Glendale has, in making loans for the purchase or construction of homes, adopted and used standardized security instruments in the form of deeds of trust and assignments of rents, which are recorded and by which the borrower hypothecates the real property security for his loan to a third party trustee, with power of sale, for the benefit of Glendale as lender; and has utilized standardized forms of promissory notes to evidence such loans. Such instruments have included, among other provisions, "due-on-sale" provisions (providing for the acceleration of the maturity of the loan at the option of Glendale upon sale or alienation of the real property security by the borrower).

13. Verdugo Service Corporation ("Verdugo") is a California corporation whose stock is wholly-owned by Wilshire Mortgage Corporation. The stock of Wilshire Mortgage Corporation is wholly-owned by Glendale.

14. Verdugo acts as a third party trustee to whom Glendale's borrowers, for the benefit of Glendale, hypothecate the real property security for their loans, as described in paragraph 10 above. As trustee, Verdugo utilizes California law to institute foreclosures, and to record and to convey said real property security at the direction of Glendale.

15. By stipulation of the parties as per Pre Trial Order, Verdugo shall not be considered a party to this action.

16. By enacting HOLA, Congress did not intend to preempt state regulation of the exercise of due-on-sale clauses by federally-chartered savings and loan associations.

17. There is no inherent need for national uniformity in the regulation of the exercise of due-on-sale clauses by federal associations.

18. On or about June 8, 1976, the Board promulgated certain regulations, 12 C.F.R. §545.6-11, concerning the use of due-on-sale clauses by federal associations ("said regulations" or "Board regulations").

19. After the commencement of this action, Glendale filed an action in the United States District Court for the Central District of California entitled Glendale Federal Savings and Loan Association v. David H. Fox, etc., et al., No. 77-3274 WMB ("Glendale v. Fox"), whereby Glendale sought a declaration that after the promulgation of said regulations, the California Real Estate Commissioner could not refuse to issue a report under the California Subdivided Land Law because the lending instruments included a due-on-sale clause which did not conform to the requirements of Cal. Civil Code §2924.6.

20. Prior to the trial in this action, the court in Glendale v. Fox issued a declaration holding that the California Real Estate Commissioner could not refuse to issue a report because the lending instruments executed after June 8, 1976 included a due-on-sale clause which did not conform to the requirements of Cal. Civil Code §2924.6. A basis of the court's decision was that said regulations of the Board promulgated in June, 1976 preempted state law. The court did not rule on the question of preemption as to those loans made prior to June 8, 1976, the date of the promulgation of said regulations.

21. Plaintiff contends that California law (Civil Code Section 711 as interpreted by the California Supreme Court in Tucker v. Lassen Savings and Loan Association, 12 Cal. 3d 629 (1974) and Wellenkamp v. Bank of America, 21 Cal. 3d 943 (1978) which precludes the automatic acceleration of a loan pursuant to a due-on-sale clause (hereinafter the "California restrictions"), is applicable to federal associations. Glendale and the Board deny plaintiff's contention and contend, inter alia, that the California restrictions cannot be applied to federal associations because (a)

under the doctrine of federal preemption federal law and regulations exclusively govern the validity and exercisability of due-on-sale clauses included in Glendale's loan instruments, (b) it would result in a burden on interstate commerce, (c) it would create an undue burden on Glendale which would interfere with its ability to perform the functions assigned to it by the federal government, and (d) it would discriminate against Glendale and in favor of state-charatered associations.

22. Plaintiff does not now seek a determination that Glendale has engaged in any conduct violative of California Civil Code Section 711 or the California restrictions.

23. The application of the California restrictions to lending instruments of federal associations executed prior to the date of the Board regulations has an insignificant impact upon Glendale.

24. The application of the California restrictions to lending instruments of federal associations in California executed prior to the date of the Board regulations has an insignificant impact upon said federal associations.

25. The application of the California restrictions to lending instruments of federal associations executed prior to the date of the Board regulations does not create an undue burden on Glendale.

26. The application of the California restrictions to lending instruments of federal associations in California executed prior to the date of the Board regulations does not create an undue burden on said federal associations.

27. The application of the California restrictions to lending instruments of federal associations in California executed prior to the date of the Board regulations does not interfere with Glendale's ability to perform any of the functions assigned to it by Congress.

28. The application of the California restrictions to lending instruments of federal associations in California executed prior to the date of the Board regulations does not interfere with the

ability of said federal associations to perform any of the functions assigned to them by Congress.

29. The application of the California restrictions to lending instruments of federal associations executed prior to the date of the Board regulations does not prohibit Glendale from carrying out any of the purposes of Congress in establishing federal associations.

30. The application of the California restrictions to lending instruments of federal associations in California executed prior to the date of the Board regulations does not prohibit said federal associations from carrying out any of the purposes of Congress in establishing federal associations.

31. The application of the California restrictions to lending instruments of federal associations in California executed prior to the date of the Board regulations does not discriminate against said federal associations in favor of state-chartered associations.

32. The application of the California restrictions to lending instruments of federal associations executed prior to the date of the Board regulations does not discriminate against Glendale in favor of state-chartered associations.

33. The application of the California restrictions to lending instruments of federal associations in California executed prior to the date of the Board regulations does not create a burden on interstate commerce.

34. The application of the California restrictions to lending instruments of Glendale executed prior to the date of the Board regulations does not create a burden on interstate commerce.

35. The application of the California restrictions to lending instruments of federal associations executed prior to the date of the Board regulations does not conflict with federal law.

36. The application of the California restrictions to lending instruments of Glendale executed prior to the date of the Board regulations does not conflict with federal law.

37. The application of the California restrictions to lending instruments of federal associations executed prior to the date of the Board regulations does not frustrate any purpose of Congress in establishing federal savings and loan associations.

38. The application of the California restrictions to lending instruments of Glendale executed prior to the date of the Board regulations does not frustrate any purpose of Congress in establishing federal savings and loan associations.

39. Glendale's evidence of the alleged effects of the California restrictions on federal associations and on Glendale is largely based on assumption and supposition.

40. Plaintiff did not unduly delay the commencement of this action.

41. Every conclusion of law herein which is determined to be a fact is hereby found as a fact and incorporated herein as a finding of fact.

CONCLUSIONS OF LAW

1. There is an actual and justiciable controversy between plaintiff and Glendale and between plaintiff and the Board as to their respective claims and contentions herein.

2. The court has jurisdiction over the Board and Glendale in this case.

3. By opposing on the merits a motion by plaintiff for summary judgment herein, the Board has waived any claim it might have that this court does not have jurisdiction over it in this action and has submitted itself to the jurisdiction of this court.

4. The parties are entitled to declaratory relief (except as to those matters which plaintiff is collaterally estopped to assert).

5. Plaintiff has standing to maintain this action.

6. This action is not barred by the doctrine of laches.

7. The propriety of the judgment in Glendale v. Fox is not an issue before this court.

8. Plaintiff is collateraliy estopped by the judgment in Glendale v. Fox to assert that California Civil Code Section 711 as interpreted by the California Supreme Court in Tucker v. Lassen, 12 Cal.3d 629 (1974), and Wellenkamp v. Bank of America, 21 Cal.3d 943 (1978) applies to the question of the validity and enforceability of due-on-sale clauses in Glendale's loan documents executed after the promulgation of said regulations (June 8, 1976).

9. California Civil Code Section 711 as interpreted by the California Supreme Court in Tucker v. Lassen, 12 Cal.3d 629 (1974) and Wellenkamp v. Bank of America, 21 Cal.3d 943 (1978) applies to the validity and enforceability of due-on-sale clauses in Glendale's lending instruments executed prior to the promulgation of said regulations (June 8, 1976).

10. Plaintiff is entitled to a declaratory judgment pursuant to Code of Civil Procedure Sections 631.8 and 1060 declaring that said California law applies to the validity and enforceability of due-on-sale clauses in Glendale's lending instruments executed prior to the promulgation of said regulations.

11. Plaintiff is entitled to its costs of suit incurred herein.

12. Every finding of fact herein which is deemed to be a conclusion of law is hereby declared to be a conclusion of law and incorporated herein as a conclusion of law.

Dated: Sept. 12, 1979.

/s/ Hon. Jack T. Ryburn

Judge of the Superior Court

THE DOCUMENT TO WHICH THIS CERTIFICATE IS ATTACHED IS A FULL, TRUE AND CORRECT COPY OF THE ORIGINAL ON FILE AND OF RECORD IN MY OFFICE:

ATTEST SEPT. 21, 1979.

/s/ JOHN J. CORCORAN

County Clerk and Clerk of the Superior Court of California, County of Los Angeles.

BY /s/ ILLEGIBLE Deputy

Amicus Brief

12

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No. 81-750

IN THE

Supreme Court of the United States

October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

REGINALD D. DE LA CUESTA, *et al.*,

Appellees.

On Appeal from the California Court of Appeal for the Fourth Appellate District.

BRIEF OF THE UNITED STATES LEAGUE OF SAVINGS ASSOCIATIONS, THE NATIONAL SAVINGS AND LOAN LEAGUE, THE CONFERENCE OF FEDERAL SAVINGS AND LOAN ASSOCIATIONS, THE CALIFORNIA SAVINGS AND LOAN LEAGUE, THE SAVINGS AND LOAN LEAGUE OF ARIZONA, THE ILLINOIS SAVINGS AND LOAN LEAGUE, THE MICHIGAN SAVINGS AND LOAN LEAGUE, INC., THE OHIO LEAGUE OF SAVINGS ASSOCIATIONS, THE TEXAS SAVINGS AND LOAN LEAGUE, AND THE INDIVIDUAL SAVINGS AND LOAN ASSOCIATIONS NAMED HEREIN, AS AMICI CURIAE IN SUPPORT OF APPELLANTS.

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No. 81-750

IN THE

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October Term, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, *et al.*,

Appellants,

vs.

REGINALD D. DE LA CUESTA, *et al.*,

Appellees.

BRIEF OF THE UNITED STATES LEAGUE OF SAVINGS ASSOCIATIONS, THE NATIONAL SAVINGS AND LOAN LEAGUE, THE CONFERENCE OF FEDERAL SAVINGS AND LOAN ASSOCIATIONS, THE CALIFORNIA SAVINGS AND LOAN LEAGUE, THE SAVINGS AND LOAN LEAGUE OF ARIZONA, THE ILLINOIS SAVINGS AND LOAN LEAGUE, THE MICHIGAN SAVINGS AND LOAN LEAGUE, INC., THE OHIO LEAGUE OF SAVINGS ASSOCIATIONS, THE TEXAS SAVINGS AND LOAN LEAGUE, AND THE INDIVIDUAL SAVINGS AND LOAN ASSOCIATIONS NAMED HEREIN, AS AMICI CURIAE IN SUPPORT OF APPELLANTS.

I.
THE IDENTITY AND INTERESTS OF THE AMICI CURIAE.

The *amici curiae* joining in this brief, filed with the written consent of the parties pursuant to Rule 36.2 of the Rules of this Court, are the United States League of Savings Associations ("the U.S. League"), a trade association whose approximately 4,400 members hold over 99% of the total savings and loan assets in this country; the National Savings

and Loan League ("the National League"), a trade association primarily concerned with federal legislative and regulatory matters affecting the savings and loan industry; the Conference of Federal Savings and Loan Associations ("the Conference"), a trade association the membership of which includes approximately 85 federally chartered savings and loan associations located in 16 states holding approximately 10% of the total savings and loan assets in the country; the California Savings and Loan League ("the California League"), a trade association whose 195 members include both state and federally chartered savings and loan associations doing business in California; the Savings and Loan League of Arizona ("the Arizona League"), a trade association the membership of which includes all state and federally chartered associations doing business in Arizona; the Illinois Savings and Loan League ("the Illinois League"), a trade association whose members hold 98% of the total savings and loan assets in Illinois; the Michigan Savings and Loan League, Inc. ("the Michigan League"), a trade association the membership of which includes all 55 state and federally chartered associations doing business in Michigan; the Ohio League of Savings Associations ("the Ohio League"), a not-for-profit Ohio corporation the membership of which includes virtually all of Ohio's 355 state and federally chartered savings and loan associations; the Texas Savings and Loan League ("the Texas League"); and a number of individual savings and loan associations.[1]

---

[1]The individual associations appearing as *amici* herein are Bay View Federal Savings and Loan Association, California Federal Savings and Loan Association, Capital Federal Savings and Loan Association, Century Federal Savings and Loan Association, City Federal Savings and Loan Association of Elizabeth, New Jersey, Coast Federal Savings and Loan Association, Colorado River Federal Savings and Loan Association, Eureka Federal Savings and Loan Association, Fidelity Federal Savings and Loan Association of Douglas, Arizona, First Federal Savings and Loan Association of Arizona, First Federal Savings and Loan Association of Bakersfield, First Federal Savings and Loan Association of San Rafael, First Federal Savings and Loan Association of South Pasadena, Frontier Savings and Loan Association, Glendale Federal Savings and Loan Association, Great American Federal Savings and Loan Association, Greater Arizona Savings and Loan Association,

The interests of the U.S. League, the National League, the Conference, the California League, the Arizona League, the Illinois League, the Michigan League, the Ohio League and the Texas League derive from the fact that each trade association has numerous members who are federal associations, and the operations and mortgage lending practices of these members will be directly and profoundly influenced by the Court's decision herein.

In addition to sharing the concerns of the trade associations, many of the individual federal associations appearing as *amici curiae* herein (as well as the Conference itself) are parties in cases currently pending in this Court or elsewhere presenting the same fundamental issue as that presented by the within appeal, namely, whether federal law preempts state law with respect to the "due-on-sale" practices of federal savings and loan associations[2] and/or hold mortgage loan contracts containing "due-on-sale" clauses.

Home Federal Savings and Loan Association of San Diego, Home Federal Savings and Loan Association of Tucson, Household Federal Savings and Loan Association, Pacific Federal Savings and Loan Association, Pasadena Federal Savings and Loan Association, Peoples Federal Savings and Loan Association, Pima Savings and Loan Association, Pomona First Federal Savings and Loan Association, Provident Federal Savings and Loan Association of Riverside, Quaker City Federal Savings and Loan Association, Redlands Federal Savings and Loan Association, Republic Federal Savings and Loan Association, Saguaro Savings and Loan Association, San Joaquin First Federal Savings and Loan Association, San Francisco Federal Savings and Loan Association, Security Federal Savings and Loan Association of Garden Grove, California, Security Federal Savings and Loan Association of Tucson, Arizona, Southwest Savings and Loan Association, Sun State Savings and Loan Association, The Heart Federal Savings and Loan Association, Twin City Federal Savings and Loan Association of Minneapolis, Universal Savings and Loan Association of Kingman, Arizona, Valley Federal Savings and Loan Association, Valley First Federal Savings and Loan Association, Western Federal Savings and Loan Association, and Western Savings and Loan Association.

[2]See e.g., *Glendale Federal Savings and Loan Association v. Fox*, No. 81-1192; *Conference of Federal Savings & Loan Association v. Stein*, No. 81-1192; *Glendale Federal Savings & Loan Association v. Hehir*, No. 81-992; *Glendale Federal Savings & Loan Association v. Gross*, No. 81-1139; *People v. Glendale Federal Savings & Loan Association*, No. 81-1503; and *Great American Federal Savings & Loan Association v. Nalore*, No. 81-1462.

The interests of the Arizona-chartered savings and loan associations appearing as *amici curiae* herein derive from the fact that Arizona law, specifically Arizona Revised Statutes § 6-402, provides that such associations have the same "rights, powers and privileges" as federal associations.

II.
PRELIMINARY STATEMENT.

A primary function of "due-on-sale" clauses is to enable mortgage lenders, who extend credit to borrowers for terms of as long as thirty years while paying their own depositors what are essentially prevailing market rates, to adjust the interest yield on their loan portfolios to compensate for increases in the cost of lendable funds. In many, and perhaps most, American jurisdictions the use of the "due-on-sale" clause for that purpose is sanctioned as lawful and consonant with sound public policy. See, e.g., *Occidental Savings & Loan Association v. Venco*, 206 Neb. 469, 293 N.W.2d 843 (1980); *Dunham v. Ware Savings Bank*, ____ Mass. ____, 423 N.E.2d 998 (1981); *Crestview, Ltd. v. Foremost Insurance Co.*, 621 S.W.2d 916 (Tex. Civ. App. 1981).

Prior to 1974 California sanctioned the use of the "due-on-sale" clause for the purpose of enabling long-term mortgage lenders to keep the yield on their loan portfolios in line with the cost of lendable funds.[3] In 1974, however, the California Supreme Court, in *Tucker v. Lassen Savings & Loan Association*, 12 Cal.3d 629, 526 P.2d 1169 (1974),

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[3]Indeed, at least one California intermediate appellate court, in *Cherry v. Home Savings & Loan Association*, 276 Cal.App.2d 574, 579 (1969), explicitly recognized that incorporating a "due-on-sale" clause into a mortgage loan contract in order to "take advantage of rising interest rates in the event his borrower transfers the security . . . is merely one example of ways taken to minimize risks by sensible lenders". Accord: *La Sala v. American Savings & Loan Association*, 5 Cal.3d 864, 869-871, 489 P.2d 1113, 1115-1117 (1971); *Coast Bank v. Minderhout*, 61 Cal.2d 311, 317, 392 P.2d 265 (1964); *Hellbaum v. Lytton Savings & Loan Association*, 274 Cal.App.2d 456, 458-459 (1969); *Jones v. Sacramento Savings & Loan Association*, 248 Cal.App.2d 522, 527 (1967).

reinterpreted California law, departed from the view of other American jurisdictions, and concluded that the exercise of a "due-on-sale" clause for the purpose of adjusting interest rates upon the sale under an "installment land sale contract" of the real property hypothecated as security for a loan constitutes an "unreasonable restraint on alienation" in violation of California Civil Code §711.[4] Four years later, in *Wellenkamp v. Bank of America*, 21 Cal.3d 943, 582 P.2d 970 (1978), the California Supreme Court extended the prohibition articulated in *Tucker* to outright sales.[5]

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[4]The common law proscribed restraints on alienation of three types: disabling, forfeiture and promissory. A disabling restraint is one that purports to withhold from the vestee of title the power to alienate; a forfeiture restraint is one that provides that if the vestee of title attempts to alienate, title will either revert to the grantor or shift to a third person; and a promissory restraint is a promise by the vestee not to convey title the violation of which, if the restraint were valid, would subject the promissor to liability for breach of contract. See *Restatement of Property* §§404-406; Simes & Smith, *The Law of Future Interests* §1131 (2d Ed. 1956); 6 *Powell on Real Property*, §§839-843 (1973).

Does a "due-on-sale" clause fall into any of these categories? Clearly it does not. It is not a disabling restraint, since it does not purport to withhold from the mortgagor the power to convey; it is not a forfeiture restraint, since it does not provide that if the mortgagor attempts to alienate title will revert to the grantor or shift to a third person; and it is not a promissory restraint, since obviously it is not a promise by the mortgagor not to convey and by conveying the mortgagor would not render himself liable for breach of contract.

For a recent analysis of why the exercise of a "due-on-sale" clause is not a restraint on alienation, see, e.g., *Occidental Savings & Loan Association v. Venco, supra*.

[5]In *Tucker* the California Supreme Court expressly confined its discussions to the case of a sale of the real property hypothecated as security for the loan under an "installment land sale contract" in which legal title is retained by the seller and explicitly reserved the question of whether the same rule would apply in the case of an outright sale in which legal title as well as beneficial ownership is transferred, suggesting some possible distinctions between the "installment land sale contract" and "outright sale" situations and even predicating the *Tucker* decision upon such distinctions. (See 12 Cal.3d 634-39.) In *Wellenkamp*, however, the California Supreme Court repudiated the distinctions that it had drawn four years earlier in *Tucker* between the "installment land sale contract" and "outright sale" situations.

In 1975, following *Tucker* but prior to *Wellenkamp*, an action was brought in the United States District Court for the Central District of California, *Schott v. Mission Federal Savings & Loan Association*, U.S.D.C. (C.D. Cal.) No. CV 75-366-WMB, seeking, *inter alia*, a declaration that since there was no impairment in security, the defendant, a federally chartered savings and loan association, was precluded under California law from exercising the "due-on-sale" clause in a mortgage loan contract upon an outright sale of the real property hypothecated as security for a loan.

Prior to ruling upon the merits of the controversy, the court invited the Federal Home Loan Bank Board ("the Bank Board") to submit its views concerning the application of California state law to the mortgage lending practices of federal associations; and, in response to that invitation, the Bank Board, on June 30, 1975, rendered, pursuant to its Resolution No. 75-647, an advisory opinion ("the *Schott* Advisory Opinion") that exhaustively analyzed the pertinent legal and policy considerations.

In the *Schott* Advisory Opinion the Bank Board concluded that the existence and exercise of the "due-on-sale" clause for the purpose of adjusting interest rates to compensate for increases in the cost of lendable funds was vital to the operation of the federal saving and loan system and was authorized by a federal regulation mandating that the mortgage loan contracts of federal associations "provide for full protection to the Federal association", 12 C.F.R. §545.6-11 (now §545.8-3).

Thereafter the Bank Board instituted rule-making proceedings. On February 6, 1976, it adopted Resolution No. 76-100, proposing an amendment to the Code of Federal Regulations; and on April 28, 1976, it adopted a second resolution, No. 76-296, formally amending the Code of Federal Regulations with respect to the "due-on-sale" practices of federal associations. The preamble to the amendment provided both that "[a] Federal association continues

to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the associations' security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent'' and that ''. . . it was and is the Board's intent to have . . . due-on-sale practices of Federal associations governed exclusively by Federal law . . . [and that] Federal associations shall not be bound by or subject to any conflicting State law which imposes different . . . due-on-sale requirements . . . .'' See also 12 C.F.R. §556.9(j) (46 Fed.Reg. 39,123 (1981)).

It is against this background that the California Court of Appeal for the Fourth Appellate District, Division Two (''the Court of Appeal''), concluded that California law as interpreted in *Wellenkamp* governs the ''due-on-sale'' practices of federal associations.

III.
SUMMARY OF ARGUMENT.

Under the ''supremacy clause'' Congress is empowered to preempt any legislative field over which it has jurisdiction, and when it does so any state law in the field is inapplicable. It is apparent from the language and purpose of HOLA, the applicable case law, and the regulations promulgated by the Bank Board, that Congress has preempted the legislative field here in question, the mortgage loan (including ''due-on-sale'') practices of federal associations, and that consequently California law is inapplicable.

IV.
ARGUMENT.

A. Under the ''Supremacy Clause'' Congress Is Empowered to Preempt Any Legislative Field Over Which It Has Jurisdiction, and When It Does So Any State Law in the Field Is Inapplicable.

Congress, by virtue of the supremacy clause of the United States Constitution (Art. VI, cl. 2), is empowered to preempt any legislative field over which it has jurisdiction; and when

such preemption occurs any state law in the field, whether consistent or inconsistent with the federal legislation, is inapplicable. *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624, 633 (1973); *Parker v. Brown*, 317 U.S. 341, 350 (1943). The practices of agencies and instrumentalities of the United States is, of course, a legislative field over which Congress has jurisdiction, and federal savings and loan associations are such agencies and instrumentalities. *Federal Land Bank v. Bismarck Lumber Co.*, 314 U.S. 95, 102 (1941); *United States v. State Tax Commission*, 481 F.2d 963, 969 (1st Cir. 1973).[6]

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[6]In the absence of an express congressional declaration upon the point, the existence of preemption may be implied from the nature of federal legislation and the subject matter in question:

> "It long has been the rule that exclusion of state action may be implied from the nature of the legislation and the subject matter although express declaration of such result is wanting." (*Bethlehem Steel Co. v. New York State Labor Relations Board*, 330 U.S. 767, 772 (1947).)

Moreover, preemption may take place simply by vesting in a federal administrative agency comprehensive authority to prescribe regulations governing the preempted field, and such preemption will render inapplicable even those state laws dealing with a phase of the subject to which the administrative regulations do not address themselves:

> "When Congress has outlined its policy in rather general and inclusive terms and delegated determination of their specific application to an administrative tribunal, the mere fact of delegation of power to deal with the general matter, without agency action, might preclude any state action if it is clear that Congress has intended no regulation except its own.
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> "*But when federal administration has made comprehensive regulations effectively governing the subject matter of the statute, the Court has said that a state regulation in the field of the statute is invalid even though that particular phase of the subject has not been taken up by the federal agency.*" (*Id.*, 330 U.S. 773-774; emphasis added.)

Accord: Merrill Lynch, Pierce, Fenner & Smith, Inc. v. Ware, 414 U.S. 117, 139-140 (1973); *Pennsylvania v. Nelson*, 350 U.S. 497, 502-504 (1956); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947); *Northern States Power Co. v. Minnesota*, 447 F.2d 1143, 1146, 1152 (8th Cir. 1971), *aff'd mem.*, 405 U.S. 1035 (1972). See also *Conference of Federal Savings & Loan Associations v. Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980) ("[i]mplicit preemption can be found where the scheme of federal regulation is so pervasive as to make reasonable the inference that there is no room for state action").

In the instant case the conclusion that federal law has preempted state law with respect to regulation of the mortgage loan practices (including the "due-on-sale" practices) of federal savings and loan associations is inescapable.[7]

B. It Is Apparent From the Language and Purpose of HOLA, the Applicable Case Law, and the Regulations Promulgated by the Bank Board, That Congress Has Preempted the Legislative Field Here in Question, the Mortgage Loan (Including "Due-on-Sale") Practices of Federal Associations, and That Consequently California Law Is Inapplicable.

1. HOLA and the Purpose for Which It Was Enacted.

Probably the most basic criteria for ascertaining the existence of federal preemption are the language of the statute involved and the congressional purpose for which it was enacted. *Rice v. Santa Fe Elevator Corp., supra; Northern States Power Co. v. Minnesota, supra; Fitzgerald v. Catherwood*, 388 F.2d 400 (2nd Cir.), *cert. denied*, 391 U.S. 934 (1968). The purpose of Congress in creating the federal savings and loan system was to establish a pattern

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[7]Although few courts expressly acknowledge the distinction, conceptually preemption may occur 1) through promulgation of appropriate regulations by a responsible administrative agency; or 2) by enactment of a federal statute that, in and of itself, effects preemption. See *Amalgamated Association of Street, Electric Railway & Motor Coach Employees of America v. Lockridge*, 403 U.S. 274, 288 (1971); *Campbell v. Hussey*, 368 U.S. 297, 300-301 (1961); *Pennsylvania v. Nelson*, 350 U.S. 497, 504 (1956); *Rice v. Santa Fe Elevator Corp., supra; Hines v. Davidowitz*, 312 U.S. 52, 66-67 (1941); *Northern States Power Co. v. Minnesota, supra*. *Amici curiae* submit that the enactment of HOLA and its delegation to the Bank Board of plenary authority over federal associations, in and of itself, preempted the field of regulation of the mortgage lending practices of federally chartered savings and loan associations; and that consequently the existence of preemption does not turn upon the promulgation by the Bank Board of specific regulations in the area that a state is attempting to control. Be that as it may, however, in this case the Bank Board *has* promulgated regulations sufficient to preempt the field with respect to "due-on-sale" practices; and thus for purposes of the within appeal it is not necessary to determine whether or not HOLA itself effects the requisite preemption.

of federal leadership in home financing; and federal preemption of the regulation of the system was essential to the achievement of that objective.

In 1932 Congress, in an effort to ameliorate the prevailing emergency in home financing, enacted the Federal Home Loan Bank Act to make available to the public a reserve source of capital for home financing. Pursuant to that objective, the statute created a new federal administrative agency, the Bank Board, and directed that agency to charter a series of twelve Federal Home Loan Banks that would (1) serve as wholesale banks for member financial institutions, and (2) under Section 4(d), make mortgage loans directly to members of the general public (12 U.S.C. §1421 *et seq.*).

Enactment of the statute did not, however, produce any meaningful amelioration of the problem. The nation's home financing system continued to deteriorate; and by 1933 an incredible 49% of all home loans in the United States were in default.[8] One reason that the Federal Home Loan Bank Act failed to deal adequately with the emergency was that it made no attempt to reform the existing state-run home financing system. While general economic conditions would probably have had a severe impact upon home financing in any event, pernicious state practices magnified that impact and transformed what would otherwise have been a crisis into a calamity. These practices included the use, on a broad scale, of mortgage contracts calling for balloon payments and "sinking fund" loans.[9]

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[8]Federal Home Loan Bank Board, *The Federal Home Loan Bank System*, p. 13 (1971).

[9]The character and pitfalls of the "sinking fund" loan are described in Stanford Research Institute, *The Savings and Loan Industry in California* §III-37 (1960): "In the share account-sinking fund loan plan, principal payments were first accumulated in a compulsory savings account until the balance, together with any dividends which had been credited to the account, equaled the amount of the loan, at which time the loan was paid off. Among the disadvantages of this plan were that the loan took longer to mature than expected if dividend rates were reduced, *share values could be written down in case of reorganization, and entire share accounts could be sacrificed in case of liquidation, including those required of borrowers. The borrower, however, still owed the full amount of the mortgage.*" (Emphasis added.)

What was needed, therefore, was not a recapitalization or minor modification of the existing system, but a radical and comprehensive overhauling of such system. That overhauling was what HOLA provided.

HOLA had a number of components. First, it repealed §4(d) of the Federal Home Loan Bank Act, authorizing direct home loans by the Federal Home Loan Banks.

Second, a new corporation, the Home Owners' Loan Corporation ("HOLC"), was created and authorized to exchange its bonds, the interest on which was exempt from both state and federal taxation and guaranteed as to repayment by the federal government, for mortgages held by various financial intermediaries, including state chartered building and loan associations.[10] Mortgages acquired by such exchange, however, had to provide for direct repayment in amortized monthly installments, each installment (except the last) to be the same for the life of the loan and not to exceed any earlier installment. Loans that called for "balloon payments" or that provided for repayment by a "sinking fund" had to be rewritten — this despite the fact that such loans were in widespread and perhaps dominant use throughout the United States at the time. Thus the mortgage exchange program had, as one of its clear objectives, the suppression of state practices concerning mortgage loan contracts and their replacement with practices conforming to uniform federal standards.[11]

Third, HOLA created the federal savings and loan system. In creating that system, Congress could have elected to subject the operations of federal associations to state law. To do so, however, would have been to perpetuate in the new federal system precisely the same pernicious state prac-

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[10]Initially the guarantee was only as to interest, but later it was extended to both principal and interest.

[11]The purpose and function of the Home Owners' Loan Corporation were discussed in an article first published in 1939 and reprinted in F.T. Greene, *Thrift and Home Ownership*, 29-30 (L.T. Kendall, ed. 1962).

tices that HOLA was designated to eliminate, and would have been an anathema to a Congress so acutely cognizant of the failings of the existing state-controlled home financing system. Thus the basic provision of HOLA authorizing the creation of the federal savings and loan system, §5(a) [12 U.S.C. §1464(a)], contains a delegation by Congress to the Bank Board of plenary authority over the creation and operation of federal associations:

> "In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, *under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation and regulation* of associations to be known as 'Federal Savings and Loan Associations,' . . . and to issue charters therefor, *giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States*." (Emphasis added.)[12]

The only reasonable construction that could be placed upon such language, and the construction that has been placed upon such language by the courts, is that the Bank Board was given a mandate to govern, in a comprehensive manner, the activities of federal associations by adopting uniform national regulations, which regulations would respect the Bank Board's "primary consideration" of the

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[12]All of the other provisions of HOLA dealing with the federal savings and loan system are merely qualifications to, or limitations upon, §5(a).

In a letter dated April 13, 1933, President Franklin D. Roosevelt described the legislative intent underlying the enactment of HOLA as follows:

> "*Implicit* in the legislation . . . is a declaration of *national policy*. This policy is that the broad interests of the Nation require that special safeguards should be thrown around home ownership as a guaranty of social and economic stability." (H.R. Doc. No. 19, 73rd Cong., 1st Sess. 1681, 1702 (1933); emphasis added.)

"best practices" of state-chartered thrift institutions, to the exclusion of state law.[13]

2. The Applicable Case Law.

The existing case law overwhelmingly supports the conclusion that HOLA and the regulatory scheme promulgated thereunder by the Bank Board exclusively govern the operation of federal savings and loan associations to the exclusion of state law and regulation by state authorities.

In *People v. Coast Federal Savings & Loan Association*, 98 F.Supp. 311 (S.D. Cal. 1951), the People of the State of California and the then California Superintendent of Banks sought an injunction and the recovery of statutory penalties against Coast Federal Savings and Loan Association ("Coast Federal") on the ground that "through signs and other means of advertising, defendant [Coast Federal] has transacted business in the manner of a bank and has . . . led the public to believe that it was such a bank, without authority and in violation of state statutes." (98 F.Supp.

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[13]This Court need not, of course, endeavor to ascertain *de novo* the intent of Congress in enacting HOLA in 1933. When (1) a statute is interpreted in a particular manner by a court or the governmental agency responsible for administering the statute, and (2) Congress, although it has an opportunity to do so (as, for example, when Congress amends another part of the statute) does not amend the statute to alter the judicial or administrative interpretation thereof, the interpretation reached by the court or agency is presumed correct. As this Court stated in *Lorillard v. Pons*, 434 U.S. 575, 580-581 (1978):

> "Congress is presumed to be aware of an administrative or judicial interpretation of a statute and to adopt that interpretation when it reenacts a statute without change." (Citations omitted.)

See also, *e.g., Francis v. Southern Pacific Co.*, 333 U.S. 445, 450 (1948); *Rath Packing Co. v. Becker*, 530 F.2d 1295, 1312 (9th Cir. 1975), *aff'd sub nom., Jones v. Rath Packing Co.*, 430 U.S. 519 (1977). Here both the Bank Board and courts throughout the nation have interpreted HOLA as intended to preempt state law regarding the mortgage lending practices of federal associations. Yet Congress, in enacting amendments to §5(a) of HOLA on at least six different occasions since 1976, when 12 C.F.R. §545.8-3(f) and (g) were originally promulgated, has not acted to reject or alter the interpretation placed upon HOLA by the courts and by the Bank Board.

315.) The District Court dismissed the action, finding that HOLA established a uniform national system of federal associations, that the Bank Board, as the federal regulatory agency charged with responsibility for supervising those federal associations, had prescribed its own regulation to control their advertising practices, and that therefore the state laws on the subject of advertising were inapplicable.

In *Meyers v. Beverly Hills Federal Savings & Loan Association*, 499 F.2d 1145 (9th Cir. 1974), an action against, *inter alia*, eight federal associations, the plaintiffs challenged the legality of provisions of the mortgage loan contracts of the defendants authorizing them to assess charges in the event that the principal of a loan was repaid prior to maturity, contending that such provisions were void as illegal under former California Civil Code §§1670 and 1671. The District Court dismissed the action as against the federal associations on the ground that federal law had preempted the field, rendering §§1670 and 1671 inapplicable to the mortgage loan contracts of such associations. (499 F.2d 1146.) On appeal the Ninth Circuit affirmed, explaining:

> ". . . All of the appellee federal savings and loan associations operate and are organized and chartered under the Home Owners' Loan Act of 1933, 12 U.S.C. Section 1461 et seq. This Act established the Federal Home Loan Bank Board, which 'is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as "Federal Savings and Loan Associations," and to issue charters therefor. . . .' 12 U.S.C. §1464(a).
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> "Pursuant to its valid statutory authority, the Federal Home Loan Bank Board has promulgated comprehensive regulations covering all aspects of every federal

savings and loan association 'from its cradle to its corporate grave.' " (499 F.2d 1146-1147.)[14]

In *Kaski v. First Federal Savings & Loan Association of Madison*, 72 Wis.2d 132, 240 N.W.2d 367 (1976), the plaintiffs brought a purported class action against a federal association contending that a provision in its mortgage loan contracts authorizing it to increase the interest rate on the loans was invalid under state law. The Wisconsin Supreme Court held that federal law had preempted regulation of the investment and lending practices of federal associations, and Wisconsin state law was therefore inapplicable:

". . . it is apparent that Congress has substantially occupied the field in regard to the regulation of federal savings and loan associations, particularly in the area of the regulation of lending practices. This scheme of federal regulation is pervasive. Moreover, it has long been held that the establishment of a federal system of banking or of lending is of such importance in our national life that, for the most part, state laws should not be allowed to interfere. *McCulloch v. Maryland* (1819), 17 U.S. (4 Wheaton) 316, 4 L.Ed. 579. It is apparent that the Congress considered that the regulation of lending procedures of federal institutions was

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[14]With respect to the specific area of controversy in *Meyers*, prepayment charge provisions in mortgage loan contracts, the Ninth Circuit answered the contention that such contractual provisions in the mortgage loan contracts of federal associations were invalid under §§1670 and 1671 as follows:

"Section 545.6-12(b) [specifically covering the area of prepayment charges] represents a valid exercise of the Federal Home Loan Bank Board's delegated power, and we therefore hold *that federal law preempts the field of prepayments of real estate loans to federally chartered savings and loan associations, so that any California law in the area is inapplicable to federal savings and loan associations operating within California.*" (499 F.2d 1147; emphasis added; footnotes omitted.)

one that required national and uniform regulation." (240 N.W.2d 372.)[15]

In *First Federal Savings & Loan Association of Boston v. Greenwald*, 591 F.2d 417 (1st Cir. 1979), the United States Court of Appeals for the First Circuit was confronted with the question of whether a state law requiring the payment of interest on funds held by lenders in escrow to defray taxes and insurance on real property hypothecated as security for loans was preempted by HOLA and a regulation of the Bank Board promulgated thereunder, 12 C.F.R. §545.6-11(c). The court answered that question in the affirmative, explaining:

> "The Supremacy Clause requires the invalidation of any state law that either falls within an area exclusively occupied by federal law or actually conflicts irreconcilably with a federal law. We think that Mass.G.L. c. 183, § 61, as applied to federal savings and loan associations, actually conflicts with 12 C.F.R. § 545.6-11(c) and therefore is preempted.
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> "The Home Owners' Loan Act grants to the Bank Board regulatory authority over the operation of federal savings and loan associations. Pursuant to this authority, the Bank Board has issued detailed regulations governing the 'operations of every Federal savings and loan association from its cradle to its corporate grave.' One such regulation is 12 C.F.R. § 545.6-11(c), which specifies the the conditions under which the federal associations must pay interest on escrow accounts."
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[15]See also *First Federal Savings & Loan Association of Boston v. State Tax Commission*, 437 U.S. 255, 258 n. 3 (1978), in which this Court noted that ". . . the federal statute [HOLA] protects federal associations from being forced into the state regulatory mold".

"It is manifest that application of the Massachusetts requirements to federal savings and loan associations would contradict the Bank Board's regulation. . . . We therefore conclude that Mass. G.L. c. 183, § 61's applicability to federal savings and loan associations is preempted by federal law." (591 F.2d 425-426; footnotes and citations omitted.)

In its recent decision in *Conference of Federal Savings & Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980), which held that the procedural aspects of California's "fair lending" laws were inapplicable to federal associations, the Ninth Circuit observed as follows:

"The Home Owners' Loan Act of 1933, 12 U.S.C. §§1461 et seq. (HOLA), was the result of congressional dissatisfaction with state law and practice in the financing of home construction. The first federal effort was through the Home Loan Bank Act of 1932. This failed to attack the problem satisfactorily.

* * *

"The result was HOLA, a radical and comprehensive response to the inadequacies of the existing state systems. A *federal* savings and loan system was created. The Federal Home Loan Bank Board (the Bank Board) was created with extremely broad powers to promulgate rules and regulations.

* * *

"With reference to HOLA, one writer has stated: '. . . the states had developed a hodgepodge of savings and loan laws and regulations, and Congress hoped that FHLBB [Bank Board] rules would set an example for uniform and sound savings and loan regulations.' "

* * *

"In our judgment the regulatory control of the Bank Board over federal savings and loan associations is so

pervasive as to leave no room for state regulatory control." (604 F.2d 1257-1258, 1260; citations omitted.)[16]

In addition to the foregoing, the vast majority of state and federal courts that have considered the question have concluded that federal law preempts state law with respect to the particular lending practice here in question, the validity and exercisability of "due-on-sale" clauses. Illustrative of such decisions is *First Federal Savings & Loan Association of Gadsen County v. Peterson*, 516 F.Supp. 732 (N.D. Fla. 1981), in which the District Court stated as follows:

> "Federal regulation on the subject of due-on-sale clauses is pervasive. It is direct; it is explicit; and it leaves no room for state law on the subject be it harsher or more lenient." (516 F.Supp. 738.)[17]

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[16]The Ninth Circuit in *Conference* did not decide the question of whether federal law preempted the substantive, as contrasted with the procedural, aspects of California's "fair lending" laws. *In addressing the matter, however, it expressly recognized that if federal law did not preempt the substantive aspects of California's "fair lending" laws, it was because other federal statutes (i.e., federal antidiscrimination laws) overrode the preemption that would otherwise have been effected by HOLA and regulations of the Bank Board promulgated thereunder — not because HOLA and the regulations promulgated thereunder would themselves have failed to preempt.* (See 604 F.2d 1260.)

[17]See also, e.g., *Price v. Florida Federal Savings & Loan Association*, 524 F.Supp. 175 (M.D. Fla. 1981); *Collins v. First Federal Savings & Loan Association of Walla Walla*, No. C-80-334 (E.D. Wash. May 18, 1981); *First Federal Savings & Loan Association of Phoenix v. Development & Management Enterprises, Inc.*, No. CIV 79-880 PHX-EHC (D. Ariz., April 2, 1981); *Dantus v. First Federal Savings & Loan Association of Denver*, 502 F.Supp. 658 (D. Colo. 1980); *Great Western Union Federal Savings & Loan Association v. Walters*, No. C 79-906V (W.D. Wash., June 18, 1980); *Williams v. First Federal Savings & Loan Association of Arlington*, 500 F.Supp. 307 (E.D. Va. 1980), *aff'd*, 651 F.2d 910 (4th Cir. 1981); *Conference of Federal Savings & Loan Associations v. Stein*, 495 F.Supp. 12, 16 (E.D. Cal. 1979), *rev'd on other grounds*, 663 F.2d 1078 (9th Cir.), *pet. for cert. docketed*, No. 81-1192 (1981); *Bailey v. First Federal Savings & Loan Association of Ottawa*, 467 F.Supp. 1139 (C.D. Ill. 1979); *Glendale Federal Savings & Loan Association v. Fox*, 459 F.Supp. 903, 912 (C.D. Cal. 1978) and 481 F.Supp. 616 (C.D. Cal. 1979), *rev'd on*

In summary, there is an overwhelming body of authority in state and federal courts across the country conclusively establishing that federal law has preempted the field with respect to the mortgage lending, including "due-on-sale", practices of federal associations.[18]

3. Interference With the Operation of HOLA.

The conclusion that HOLA was intended by Congress to preempt state law with respect to the mortgage lending practices of federal associations is clear. Be that as it may, however, a federal statute necessarily preempts state law

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other grounds, 663 F.2d 1078 (9th Cir.), *pet. for cert. docketed*, No. 81-1192 (1981); *Haugen v. Western Federal Savings & Loan Association of Denver*, 663 P.2d 497 (Col.App. 1981); *First Federal Savings & Loan Association v. Duncan*, No. BD-CV-96 (Dist. Ct., Routt Cty., Colo., Sept. 17, 1980); *Dunham v. Ware Savings Bank*, ____ Mass. ____, 423 N.E.2d 998 (1981); *Fischer v. First Federal Savings & Loan Association of Lenawee County*, No. 80-01-756, (Circuit Ct., Lenawee Cty., Mich., Jan. 19, 1981); *Northwestern Federal Savings & Loan Association v. Ternes*, No. 12,694 (Dist. Ct., So. Cen. Jud. of N.D., March 12, 1981); *McManus v. Rocky Mountain Federal Savings & Loan Association*, No. 88-494 (Dist. Ct., First Jud. Dist. of Wyo., June 17, 1980).

[18]In reaching the contrary conclusion, the California Court of Appeal herein simply disregarded this vast body of directly conflicting case law.

Moreover, to the extent that it did not simply ignore conflicting case law, it misinterpreted it. The opinion characterizes a series of reported cases, including *Conference of Federal Savings & Loan Associations v. Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980), *Meyers v. Beverly Hills Federal Savings & Loan Association*, *supra*, and *Kaski v. First Federal Savings & Loan Association of Madison*, *supra*, as dealing with the "internal" affairs of federal savings and loan associations, in contradistinction to the case at bar which, presumably, deals with the "external" affairs of such associations. (121 Cal.App.3d 340-341, 175 Cal.Rptr. 474.) The contradistinction is patently invalid. Each of the afore-cited cases deals with *an aspect of the mortgage lending practices of federal associations*, just as the within action deals with *an aspect of the mortgage lending practices of federal associations*. *Conference*, for example, dealt with the "fair lending" practices of federal associations; *Meyers* dealt with the prepayment charge practices of federal associations; and *Kaski* dealt with the interest escalation practices of federal associations. Upon what conceivable basis, therefore, can a distinction legitimately be drawn based upon the "internal vs. external" affairs criterion?

when the application of state law would impair or interfere with the operation of that statute. *White Mountain Apache Tribe v. Bracker*, 448 U.S. 136, 100 S.Ct. 2578, 2586-2587 (1980); *Jones v. Rath Packing Co.*, 430 U.S. 519, 543 (1977); *Doctors Hospital, Inc. v. Silva Recio*, 558 F.2d 619, 622 (1st Cir. 1977).

Here HOLA directs the Bank Board to determine the lending practices of federally chartered associations. Yet it is apparent that application of California Civil Code §711 as interpreted in *Wellenkamp*, *supra*, or any other provisions of California law that might impede the exercise of the "due-on-sale" clause, would interfere with the operations of HOLA by making it infeasible for the Bank Board to prescribe basic terms of the mortgage loan contracts offered by federal associations, and particularly the ability of the Board to require federal associations to offer long-term loans at fixed rates of interest repayable in level installments.[19]

Historically the predominant if not exclusive form of mortgage loan contract employed by federally chartered associations for residential real estate loans prior to the adoption of 12 C.F.R. §545.8-3(f) and (g) in 1976 has provided for a long-term extension of credit at a fixed rate of interest and for repayment in level installments. While the Bank Board has not always expressly prohibited the use of "balloon payment" or variable interest rate loans for residential lending, in 1972 the Bank Board did effectively codify such a prohibition by amending the definition of the term "installment loan," as that term affected the authorization contained in the 1972-79 versions of 12 C.F.R.

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[19]*Amici curiae* will illustrate the interference with the ability of the Bank Board to determine the lending practices of federal associations that would result from applying California law to the "due-on-sale" practices of federal associations by reference to the situtation prevailing in 1976 when what is now 12 C.F.R. §545.8-3(f) and (g) was adopted. In fact, however, because of the dramatic increase in interest rates that has taken place since then, the interference would be even more pronounced at a later date.

§545.6-1(a) providing that "installment loans . . . may be made on homes . . . repayable monthly within 30 years," to read as follows:

> "The term 'installment loan' means any loan repayable in regular periodic payments sufficient to retire the debt, interest and principal, within the loan term. However, no required payment after the first payment shall be more, but may be less than any preceding payment." (37 Fed. Reg. 5118 (1972).)[20]

Moreover, although the Bank Board traditionally required federal associations to make long-term extensions of credit at fixed rates of interest, borrowers did not have a corresponding commitment to retain mortgage credit once it has been extended to them. The Bank Board promulgated a regulation that permits a borrower to prepay a loan at any time without a prepayment charge unless the loan contract specifically provides otherwise; and in the case of "a loan secured by a home or combination of home and business property", in no event may the amount of the charge exceed

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[20]In abjuring "balloon payment" and variable interest rate mortgage loan contracts, the Bank Board was acting in accord with the explicit will of Congress. On February 6, 1975, the Bank Board adopted a resolution, No. 75-118, proposing that federal associations be expressly authorized to make variable interest rate residential loans. The Senate, however, responded by adopting a proposed joint "sense of Congress" resolution admonishing the Bank Board to refrain, pending further study, from granting such authorization:

> "Resolved by the Senate (the House of Representatives concurring), that it is the sense of the Congress that the Federal Home Loan Bank Board shall refrain from authorizing, by rule, regulation, or otherwise, a Federal savings and loan association to offer loans with variable interest rates and secured by one-to four-family homes or dwelling units unless Congress specifically, by law, authorizes such variable interest rates." (121 Cong. Rec. 8991-8993 (June 16, 1975).)

The House of Representatives, which had earlier considered a bill, H.R. 6209, that was intended to prohibit variable interest rate mortgage loan contracts (see 121 Cong. Rec. 18, 612-18,630 (May 8, 1975)), found it unnecessary to consider the proposed resolution, because the Bank Board had understandably withdrawn its proposal.

"6 months' advance interest on the part of the aggregate amount of all prepayments made on such loan in any 12-month period which exceeds 20 percent of the original principal amount of the loan." (12 C.F.R. §545.8-5.) Hence a borrower could take advantage of any downward fluctuation in interest rates to obtain more favorable terms, thereby tending to reduce the average yield on the loan portfolio of a federal association to the lowest rate prevailing during a given period. In most situations a decline of no more than three-quarters of one percent in interest rates would be sufficient (not considering loan fees and expenses) to make refinancing profitable for the mortgagor.

While the Bank Board determined that federal associations make long-term, fixed rate, level payment loans, and that such loans be repayable by the borrowers on liberal terms, most of the funds that federal savings and loan associations utilized for lending were committed to them for relatively short durations. (See, *e.g.*, Federal Home Loan Bank of San Francisco, *Commentary*, February, 1977, p. 4.)[21] Thus in order to retain such funds (and provide depositors with a fair return on their money) federal associations were required, in general, to pay interest in accordance with prevailing market rates.

Paying the prevailing interest rate on deposited funds while receiving only a fixed return on loaned funds subject to prepayment at will on liberal terms would not present any particular difficulty to federal associations if interest rates remained stable, or even if upward and downward fluctuations were fairly equal. Since loans are normally made over a period of time, the profitable and unprofitable loss would tend to balance each other out. In point of fact, however, interest rates have not remained stable, and up-

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[21]The only significant source of funds that are committed to them for long periods is what they are able to raise through such devices as the issuance of mortgage-backed bonds.

ward and downward interest fluctuations have not tended to be equal. On the contrary, while interest rates, and therefore the interest that an association has been forced to pay to attract and retain lendable funds, remained relatively stable from the late 1940's until the mid 1960's, since then they have risen dramatically. Between 1965 and 1976 the average cost of lendable funds for all insured associations in the Eleventh Federal Home Loan Bank District (which consists of California, Arizona and Nevada) rose from 4.73 percent per annum to 6.39 percent per annum, with a sharp increase of approximately eight-tenths of a percent occurring between 1972 and 1974.[22] The fluctuations have had a dra-

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[22]The pattern is illustrated by the following table:

Average Cost of Funds and Average Portfolio Yield
Insured Savings & Loan Associations —
Eleventh Federal Home Loan Bank District

Mortgage Yield	Year	Average Cost of Funds	Average Portfolio
	1965	4.73%	6.37%
	1966	5.03	6.34
	1967	5.19	6.39
	1668	5.10	6.52
	1969	5.23	6.60
	1970	5.62	6.81
	1971	5.58	6.97
	1972	5.53	7.08
	1973	5.71	7.20
	1974	6.30	7.45
	1975	6.39	7.70
	1976	6.39	7.92

Sources: *Federal Home Loan Bank Board Journal*, December 1973, Tables S.4.8 and S.4.10; Federal Home Loan Bank of San Francisco, *Operating Ratios Summary*, June 30, 1973, page 1, and December 31, 1976, page 1. In the first half of 1981, the average costs of funds for associations in the Eleventh District was 11.09%, while the average portfolio yield was 10.34%. *Federal Home Loan Bank Board Journal*, January 1982, Tables S.4.8 and S.4.10.

matically adverse impact upon the profitability of existing loans.[23]

Hence to the extent that they retained loans for their own portfolios, federal associations, if they were to utilize long-term, fixed rate, level payment mortgage loan contracts, required some method for bringing the income on loaned money into proper relationship with the cost of lendable funds.

One such method is to exercise the "due-on-sale" clause upon a sale of the property, thereby limiting the duration of the loan. Given the rate at which people move, the effect

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[23]The effect of fluctuations in the cost of lendable funds upon the profitability of existing loans is illustrated by the following table:

Net Income of Mortgages Closed Before December 31, 1965
Insured Savings and Loan Associations —
Eleventh Federal Home Loan Bank District

Year	Interest Income Per $100 of Mortgages	Average Cost of Funds Plus Operating	Net income Per $100 of Mortgages
1965	$6.37	$6.10	$ .27
1966	6.37	6.33	.04
1967	6.37	6.41	-.04
1968	6.37	6.31	.06
1969	6.37	6.47	-.10
1970	6.37	6.92	-.55
1971	6.37	6.83	-.46
1972	6.37	6.75	-.38
1973	6.37	7.01	-.64
1974	6.37	7.68	-1.31
1975	6.37	7.86	-1.49
1976	6.37	7.89	-1.52
Total	76.44	82.56	-6.12

Sources: *Federal Home Loan Bank Board Journal*, December 1973, Tables S.4.8 and S.4.10; Federal Home Loan Bank of San Francisco, *Operating Ratios Summary*, June 30, 1973, page 1, and December 31, 1976, page 1; Federal Home Loan Board, *Combined Financial Statements*, 1965, p. 86; 1966, p. 47; 1967, p. 40; 1968, p. 40; 1969, p. 40.

of this device is to reduce the average term of mortgage loans to approximately eight to twelve years.[24]

In short, applying California Civil Code §711 as interpreted by the California Supreme Court or any other provisions of California law that might impede the exercise of the "due-on-sale" clause would frustrate the objective of HOLA that the Bank Board determine the essential elements of the mortgage loan contracts of federal associations and would have severely impaired — if not abolished altogether — the ability of federal associations during the 1970's to offer long-term, fixed rate, level payment loans.[25] Ob-

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[24]See Struck, "The Average Life of a Single-Family Mortgage", *Federal Home Loan Bank Board Journal*, June 1974, pp. 15-21; Kinkade, "Mortgage Prepayments and Their Effect on S&L's", *Federal Home Loan Bank Journal*, January 1976, pp. 12-18.

The decision to utilize a long-term, fixed rate, level payment mortgage loan contract with a "due-on-sale" clause in preference to other forms of mortgage loan contracts permitting a lender to adjust to fluctuations in prevailing interest rates, is not unreasonable. Mortgage loans are normally obtained for the purpose of financing the purchase of the real property. Hence limiting the duration of the loan to the period that the mortgagor retains ownership of the property neither frustrates the purpose for which the loan was originally obtained nor defeats the reasonable expectations of the borrower. Moreover, while some borrowers are undoubtedly able to adjust to increases in the cost of real estate financing occurring during the term of the loan, for others stability in the cost of such financing is a matter of crucial importance. The fixed rate, long-term contract with the "due-on-sale" clause provides the mortgagor with assurance that financing will be available at a stable cost for the duration of his purchase. Several of the alternatives to the "due-on-sale" clause, however, provide no such assurance. With the "variable interest rate" mortgage loan contract, the borrower runs the risk of an escalation in the cost of financing; and with the short-term mortgage loan contract the borrower runs the risk of an unlimited escalation in such cost.

Without the "due-on-sale" clause, the only method available to a federally chartered savings and loan association to attempt to maintain a proper ratio between the yield on its loan portfolio and the cost of lendable funds, and yet still retain long-term, fixed rate, level payment loan contracts, would be to increase the interest rate on new loans to create a "cushion" against future increases in the cost of such funds.

[25]The State of California, in contrast to the Bank Board, is not committed to mortgage lenders offering such contracts. There has never been any explicit prohibition against the use of variable interest rate mortgage loan contracts under California law; and in 1970 a statute was adopted, Cal. Civ. Code 1916.5, applicable to banks and savings and

(footnote continued on following page)

viously, this impairment in the powers of the Bank Board was not the intent of Congress when it created the federal savings and loan system.[26]

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loan associations (including, purportedly, federal associations) which, while ostensibly placing limitations upon such contracts, implicitly sanctioned their use. Accordingly, when the California Supreme Court, in *Wellenkamp, supra*, interpreted Cal. Civ. Code §711 as prohibiting a bank from exercising the "due-on-sale" clause for the purpose of adjusting interest rates on its mortgage loan portfolio, it observed, quite correctly, that "[a]utomatic enforcement of the due-on clause is not the only method by which lenders can adjust the yield from their loan portfolios to meet increases in the cost of funds for these loans" since "[w]ith the enactment of Civil Code section 1916.5, the variable interest rate mortgage has become an attractive and viable alternative" (21 Cal.3d 952, n. 10). Indeed, at the time that *Wellenkamp* was decided in August of 1978, a huge percentage of the mortgage portfolios of California state-chartered savings and loan associations already consisted of variable interest rate loans. The three largest state-chartered savings and loan associations in California were Home Savings and Loan Association, American Savings and Loan Association, and Great Western Savings and Loan Association. As of September 30, 1978, the percentage of their mortgage loan portfolios composed of variable interest rate loans was 49%, 25%, and 51%, respectively. "*S & L Industry Trends*", Dean Witter Reynolds, Inc., May, 1979, table 29, and July, 1980, table 29.

[26]The Court of Appeal, in concluding that federal law had not preempted state law herein, placed heavy reliance upon its characterization of California's "due-on-sale" rule as a part of state "real property" law. In fact, the preemptive effect of HOLA and Bank Board regulations does not turn upon, and is not affected by, the characterization of a contrary state rule as being part of state "real property" law.

To begin with, Federal power constitutionally exercised will displace contrary state law whatever appellation is assigned to the latter. See generally *Sears Roebuck & Co. v. Stiffel*, 376 U.S. 225, 228-231 (1964); *Garner v. Teamsters, Chauffeurs & Helpers Local Union No. 776*, 346 U.S. 485, 500-501 (1953).

Furthermore, an analogy based upon a hypothetical will serve to illustrate the irrelevancy to the within appeal of the characterization of California's "due-on-sale" rule as a part of state "real property" law. In 1976 Bank Board regulations required a 20% down payment for certain categories of residential real estate loans. See 12 C.F.R. §545.6-1(a). Assume that the highest court of a state concluded that for a mortgage lender to require a 20% down payment in situations in which the lender has not established that such a down payment is necessary to protect the security for its loan inhibits the sale of such property and constitutes, therefore, an "unreasonable restraint upon alienation" and therefore is in violation of state law. Under the theory of the opinion the state law prohibition upon the requirement of down payments would be a part of state "real property" law and as such applicable to federal associations, even though in conflict with HOLA and the Bank Board's regulatory scheme for the mortgage lending practices of federal associations. See, e.g., 12 C.F.R. §545.6-2(a).

4. Bank Board Regulations in the "Due-on-Sale" Area.

As previously indicated (see footnote 7, *supra*), it is the position of *amici curiae* that HOLA itself effected a preemption of the "due-on-sale" practices of federal associations. Be that as it may, however, federal law indisputably preempts with respect to a mortgage loan practice of a federal association when the Bank Board manifests an intent to preempt by promulgating a specific federal regulation pertinent to such practice.[27] In the instant case, of course, the Bank Board *has* manifested its intent to preempt by promulgating specific regulations dealing with the "due-on-sale" practices of federal associations.[28]

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[27]See, e.g., *First Federal Savings & Loan Association of Boston v. Greenwald*, 591 F.2d 417 (1st Cir. 1979) [Bank Board regulation concerning payment of interest on escrow accounts]; *Meyers v. Beverly Hills Federal Savings & Loan Association*, 499 F.2d 1145 (9th Cir. 1974) [Bank Board regulation concerning loan prepayments]; and *Derenco, Inc. v. Benj. Franklin Federal Savings & Loan Association*, 281 Or. 533, 577 P.2d 477, 485, 495-496 (1978), *cert. denied*, 439 U.S. 1051 (1978) [Bank Board regulation concerning payment of interest on escrow accounts].

[28]The opinion of the Court of Appeal states that since "[t]he federal [due-on-sale] regulation merely authorizes and does not compel savings and loan associations to include a due-on-sale clause in their loan contracts and to exercise their rights thereunder . . . the federal loan association is not faced with physical impossibility in complying with the two regulatory schemes"; and, accordingly, that "[t]here is no 'inevitable collision' between the two regulations". (121 Cal.App.3d 341, 175 Cal.Rptr. 475.) This reasoning is faulty.

While it may be true that the federal "due-on-sale" regulation in order to afford federal associations discretion, does not mandate the inclusion or exercise of "due-on-sale" clauses and that therefore a federal association could theoretically comply with both, it *does* mandate that federal associations shall have the *option* to include and exercise such clauses *without regard to any limitations imposed by state law. In other words, the regulation authorizes federal associations to do something that state law may prohibit them from doing. How much clearer a conflict or inconsistency could there be*? See, e.g., *Sanders v. Federal National Mortgage Association*, 393 F.Supp. 739, 740 (E.D. La. 1975).

Moreover, an "inevitable collision" is not a prerequisite to the existence of preemption. In *Meyers v. Beverly Hills Federal Savings & Loan Association, supra*, for example, a federal regulation authorized — but did not require — the imposition of a prepayment charge in the event that a loan was paid off prior to its specified maturity was held to preempt state law limiting such charges.

As explained in §II, *supra*, in 1975 in the *Schott* Advisory Opinion the Bank Board concluded that the existence and exercise of the "due-on-sale" clause for the purpose of adjusting interest rates to compensate for increases in the cost of lendable funds was vital to the operation of the federal saving and loan system and was authorized by a federal regulation mandating that the mortgage loan contracts of federal associations "provide for full protection to the Federal association", 12 C.F.R. §545.6-11 (now §545.8-3):

> ". . . the Board has had a regulation in effect since 1948 which specifically requires that each 'loan contract' of a Federal savings and loan association 'shall provide for *full protection* to the Federal association.' 12 C.F.R. §545.6-11 (1975), (emphasis added). The Board has construed 12 C.F.R. 545.6-11 — and by this Advisory Opinion still so construes that regulation — as authorizing 'due on sale' clauses for Federal associations (regardless of any State law to the contrary) because . . . such clauses 'provide for full protection to the Federal associations.' " (*Schott* Advisory Opinion, p. 15.)[29]

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[29]In the course of the *Schott* Advisory Opinion the Bank Board noted that abolition of the "due-on-sale" clause as a device for adjusting interest rates would "generally require it [a federal association] to charge higher interest rates on home loans across-the-board to compensate for its substantial loss of earnings directly resulting from elimination of its right to accelerate"; but that because of the ability of California state chartered associations to utilize lending practices other than long-term, fixed rate, level payment mortgage loan contracts the impact upon them of abolishing automatic exercise of the "due-on-sale" clause would be considerably ameliorated:

> "Federal associations, however, generally are prohibited from making similar short term loans, and they presently may not make variable rate mortgage loans (12 CFR 545.6-1, 545.6-3 and 545.14). Thus, the Board is seriously concerned not only with the direct adverse consequences to Federal associations in California from eliminating the 'due on sale' clause, but also the indirect consequences resulting from such elimination which could alter the competitive equality between Federal and State associations." (*Schott* Advisory Opinion, p. 27.)

Thereafter the Bank Board, in its Resolution No. 76-100 (41 Fed. Reg. 6,283 (1976)), proposed an amendment to the Code of Federal Regulations, observing that "recently the authority of Federal associations to exercise their contractual due on sale clauses has been the subject of controversy and litigation in certain States" and that the purpose of the proposed amendment was to "clarify the existing authority of Federal associations to include due on sale clauses in their loan contracts with borrowers and to exercise such clauses." Then, in a second resolution, No. 76-296 (41 Fed. Reg. 18,286 (1976)), it finalized the amendment. The preamble to the amendment provided both that "[a] Federal association continues to be empowered to include, as a matter of contract between it and the borrower, provisions in its loan contracts . . . for the acceleration of the maturity of the loan, at the option of the association, if the borrower sells or transfers the loan security property without prior written consent of the association" and that "it was and is the Board's intent to have . . . due-on-sale practices of Federal associations governed exclusively by Federal law . . . [and that] Federal associations shall not be bound by or subject to any conflicting State law which imposes different . . . due-on-sale requirements."[30]

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[30]The opinion of the Court of Appeal acknowledges that "the *Board* has manifested *its* unqualified intention that the adopted regulations and implementing policy relating to due-on-sale clauses shall occupy a preemptive position over conflicting state law provisions"; yet it concludes that there is no preemption not because the regulation is invalid but, rather, because it does not necessarily conflict with state law. (121 Cal.App.3d 339, 175 Cal.Rptr. 473; emphasis in original.)

This analysis is both incorrect and illogical. First of all, there *is* a necessary conflict. (See footnote 28, *supra*.) Furthermore, if the regulation is *valid* and *intended to preempt, ipso facto* it *does* preempt; and if it is *not* valid, then whether or not there is a "necessary conflict" between the regulation and state law is irrelevant — there is simply no valid federal regulation.

The text of 12 C.F.R. §545.6-11(f) and (g) (now 12 C.F.R. §545.8-3(f) and (g)), provides, in pertinent part, as follows:

> "An association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. . . . [E]xercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by that contract."

Accordingly, the conclusion that federal law was intended to, and has, preempted state law with respect to the exercise of "due-on-sale" clauses by federal associations is ineluctable.

V.
CONCLUSION.

The decision of the Court of Appeal should be reversed.

Dated: March 1, 1982.

Respectfully submitted,

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Amicus Brief

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In the Supreme Court of the United States

OCTOBER TERM, 1981

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, INC., ET AL., APPELLANTS

v.

REGINALD D. DE LA CUESTA, ET AL.

ON APPEAL FROM THE CALIFORNIA COURT OF APPEAL FOR THE FOURTH APPELLATE DISTRICT

BRIEF FOR THE FEDERAL HOME LOAN BANK BOARD AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION AS AMICI CURIAE

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QUESTION PRESENTED

Whether a California statute prohibiting "restraints on alienation" of property, as applied to a "due on sale" clause in a mortgage written by a federal savings and loan association, has been preempted by the Home Owners' Loan Act of 1933, 12 U.S.C. (& Supp. III) 1461 *et seq.*, as implemented through regulations of the Federal Home Loan Bank Board.

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In the Supreme Court of the United States

OCTOBER TERM, 1981

No. 81-750

FIDELITY FEDERAL SAVINGS AND LOAN ASSOCIATION, INC., ET AL., APPELLANTS

v.

REGINALD D. DE LA CUESTA, ET AL.

ON APPEAL FROM THE CALIFORNIA COURT OF APPEAL FOR THE FOURTH APPELLATE DISTRICT

BRIEF FOR THE FEDERAL HOME LOAN BANK BOARD AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION AS AMICI CURIAE

INTEREST OF THE FEDERAL HOME LOAN BANK BOARD AND THE FEDERAL HOME LOAN MORTGAGE CORPORATION

1. The Federal Home Loan Bank Board is an independent federal regulatory agency created in 1932 and invested with plenary authority to administer the Home Owners' Loan Act of 1933, 12 U.S.C. (& Supp. III) 1461 *et seq.* (the "HOLA"). Under the HOLA, "the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations' * * *." 12 U.S.C. (& Supp. III) 1464(a). Pursuant to this mandate, the Board has promulgated regulations governing virtually every aspect of a federal savings and loan

association "from its cradle to its corporate grave." *California* v. *Coast Federal Savings & Loan Association*, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

In 1976 the Board adopted the following regulatory provision, which governs due-on-sale clauses in mortgages:

> A Federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent.

41 Fed. Reg. 18288, codified at 12 C.F.R. 545.8-3(f). See also 46 Fed. Reg. 39124[3] (1981). It has been the Board's consistent position that the validity of due-on-sale clauses is a question of national importance that must be decided in accordance with the Board's regulations rather than conflicting state laws. See Federal Home Loan Bank Board, Resolution No. 75-647 (July 30, 1975); 41 Fed. Reg. 18287 (1976). Accordingly, the Board has a direct interest in urging this Court to reverse the decision of the Court of Appeal, which significantly narrowed the scope of the Board's authority in this area.

2. The Federal Home Loan Mortgage Corporation ("FHLMC") was established[1] by the Emergency Home Finance Act of 1970, 12 U.S.C. 1451 *et seq.*, to create a secondary mortgage market[2] for the pur-

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[1] The FHLMC operates under the direction of a Board of Directors composed of the three members of the Federal Home Loan Bank Board. The capital stock of FHLMC consists solely of non-voting common stock held by the twelve Federal Home Loan Banks. See 12 U.S.C. 1452(a), 1453(a).

[2] The primary mortgage market comprises transactions between mortgage originators (lenders) and home owners or builders. The secondary mortgage market comprises sales and resales of mortgages between mortgage originators and purchasers from originators, such as the FHLMC.

chase and sale of "conventional"[3] mortgages on residential property. On a nationwide basis, the FHLMC purchases conventional mortgages from mortgage originators such as savings and loan associations and resells them to institutional investors in the form of mortgage pass-through securities. The funds received are then used by the FHLMC for further purchases of mortgages. The FHLMC's mortgage purchase and sale operations are designed to increase the availability of residential mortgage credit and, accordingly, to make additional credit available to home purchasers at decreased interest rates.

As the single largest secondary market purchaser and seller of conventional mortgages in the United States, the FHLMC has a substantial interest in the enforceability of due-on-sale clauses. These clauses are contained in the standardized mortgage instrument developed by FHLMC and, accordingly, almost every mortgage FHLMC purchases contains a due-on-sale clause. Because due-on-sale clauses tend to shorten the life of mortgages, they enhance their attractiveness to secondary market purchasers who can anticipate earlier capital returns on their investment. If the decision of the Court of Appeal in this case is upheld, the ability of the FHLMC to market its mortgage pass-through securities would be directly and adversely affected.

In addition, the Court of Appeal found support for its preemption analysis in a "law of the jurisdiction" covenant in two of the mortgages involved in this case (J.S. 19a-20a). This covenant in the mortgages was adopted from the uniform mortgage instruments developed jointly by the FHLMC and the Federal National Mortgage Association. The covenant was created in accordance with Congress' desire to assure uniformity in conventional mortgages so that they could more easily be traded on a national secondary market. See S. Rep. No. 91-761, 91st Cong., 2d Sess. 7, 25 (1970); H.R. Rep. No. 91-1131, 91st

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[3] A "conventional" mortgage is a mortgage which is not guaranteed or insured by a Federal or State agency. See 12 U.S.C. 1451(i).

Cong., 2d Sess. 7 (1970). The decision of the Court of Appeal construing that covenant as expressing a preference for local law thus has a direct and harmful effect on the FHLMC's effort to standardize conventional mortgage instruments.

STATEMENT

Appellants are a federal savings and loan association chartered by the Board pursuant to Section 5(a) of the HOLA, 12 U.S.C. (& Supp. III) 1464(a), and a wholly-owned subsidiary. Appellees purchased separate parcels of real property, each of which served as security under a deed of trust for loans made by appellants to persons who sold the property (J.S. App. 5a, 21a, 22a-23a). The deeds of trust all included a provision, commonly known as a due-on-sale clause, permitting appellants to declare the entire balance of the loan due if the property securing it is transferred without the prior written consent of the appellants (*ibid.*). Appellants exercised their option to declare the balance due. When the balance was not paid, appellants instituted non-judicial foreclosure proceedings.[4]

Appellees then filed the instant suit in the Superior Court of California for the County of Orange, seeking to enjoin the foreclosure proceedings (J.S. App. 3a). Appellees asserted that enforcement of the due-on-sale clause violated Cal. Civ. Code § 711 (West 1954), which forbids unreasonable restraints on the alienation of real property. The court granted appellants' motion for summary judgment. It concluded that the state statute is preempted by the Home Owners' Loan Act of 1933, as administered by the Board through regulations that permit enforcement of due-on-sale clauses in deeds of trust (J.S. App. 29a-31a).

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[4] Appellants were willing to consent to the transfer of the property if appellees would agree to have the interest rates on the promissory notes increased to the prevailing market rates at that time (J.S. 4).

On appeal, the Court of Appeal for the Fourth Appellate District reversed (J.S. App. 1a-26a). The court adopted in large measure an opinion by the Court of Appeal for the First Appellate District in *Panko* v. *Pan American Federal Savings & Loan Association*, 119 Cal. App.3d 916, 174 Cal. Rptr. 240 (1981) (J.S. App. 4a-5a). The Court of Appeal held that due-on-sale clauses violate California's statute prohibiting restraints on alienation of real property, as interpreted by the California Supreme Court in *Wellenkamp* v. *Bank of America*, 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978) (J.S. App. 3a-4a). The court also held that the California statute is not preempted by the Board's regulation because, in its view, the Board's preemptive intent is irrelevant; only Congress can preempt state law. In addition, the court reasoned that the California statute and the Board's regulation are not necessarily incompatible (J.S. App. 17a). The court pointed to the fact that the Board's regulation does not mandate the presence of due-on-sale clauses in every mortgage, and concluded that non-enforceability of the clauses would not impair any regulatory purpose. For the same reason, the court rejected the contention that there is a need for a uniform rule regarding the loan practices in question (J.S. App. 18a-19a). Finally, the court found "support" for its preemption analysis in a covenant in the deed of trust which provides that the deed should "be governed by the law of the jurisdiction in which the Property is located" (J.S. App. 19a-20a).

The California Supreme Court denied appellants' petition for hearing (J.S. App. 28a).

SUMMARY OF ARGUMENT

In *Free* v. *Bland*, 369 U.S. 663 (1962), and *United States* v. *Shimer*, 367 U.S. 374 (1961), this Court set forth the standards to be used to decide whether a regulation of a federal administrative agency preempts state law. The regulation must be clearly designed to displace state law and must be supported by congressionally dele-

gated authority. Applying these standards to the present case, it is clear that the Federal Home Loan Bank Board's regulation authorizing due-on-sale clauses in mortgages of federal savings and loan associations preempts California law prohibiting enforcement of those clauses.

A. The Board's regulation, 12 C.F.R. 545.8-3(f), provides unambiguously that federal associations may include and enforce due-on-sale provisions. Moreover, the Board has stated repeatedly that its regulation preempts state law restricting the use of due-on-sale provisions. Thus, the first prong of the *Free* and *Shimer* test is readily satisfied.

B. 1. It is equally clear that Congress has granted the Board ample authority to promulgate its due-on-sale regulation. In Section 5(a) of the Home Owners' Loan Act, 12 U.S.C. (& Supp. III) 1464(a), Congress empowered the Board, "under such rules and regulations as it may prescribe, to provide for the organization, * * * operation, and regulation" of federal savings and loan associations. In so doing, Congress intended for the Board to stabilize the thrift industry by adopting "the best practices" of local institutions and to thereby guarantee the existence of a reliable source of funding for private home financing. This could be achieved only if the associations were freed from a "hodgepodge" of restrictive laws in the several states. See T. Marvel, *The Federal Home Loan Bank Board* 20 (1969).

2. While the legislative history of the HOLA is sparse, nothing in it suggests that Congress intended the Board to be limited in its regulation of federal savings and loan associations. To the contrary, testimony on the HOLA bill during the House and Senate hearings, and debates on the bill on the floor of the Congress, reiterate what the language of the statute makes plain: Congress gave "the Board broad power to administer the act." 77 Cong. Rec. 2573-2574 (1933); *id.* at 2480; *Home Owners' Loan Act: Hearings on H.R. 4980 Before the House Comm. on Banking and Currency*, 73d Cong., 1st Sess. 23-24 (1933).

3. Since enacting the HOLA in 1933, Congress has not diminished the Board's authority over federal savings and loan associations. Instead, it has expanded the types of institutions subject to the Board's authority and the ability of federal associations to pursue diverse economic activities. See Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. No. 95-630, 92 Stat. 3641, and Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132. Congress has been careful when dealing with these matters to make clear that it was not altering in any way "the Bank Board's plenary authority over Federal savings and loan associations." 124 Cong. Rec. 36148 (1978); 126 Cong. Rec. H2289 (daily ed. Mar. 27, 1980). Thus, Congress has confirmed repeatedly that it intended to grant the Board comprehensive authority to prescribe federal standards for the lending practices of federal savings and loan associations.

4. With the exception of a handful of state appellate court decisions in California and Florida (including the decision in this case), and dicta in opinions of the Minnesota Supreme Court and the Fifth Circuit, every court that has considered the Board's authority under Section 5(a) of HOLA has found that it extends to virtually every aspect of the organization and operation of a federal savings and loan association. These decisions also recognize that, when the Board exercises its broad authority, its action preempts conflicting state law. Indeed, this Court has summarily affirmed a court of appeals decision holding that Board regulations concerning discriminatory practices of federal associations preempt state law imposing different requirements. See *Conference of Federal Savings & Loan Associations* v. *Stein*, 604 F.2d 1256 (9th Cir. 1979), aff'd, 445 U.S. 921 (1980).

The attempt of the Court of Appeal in this case to restrict the Board's regulatory authority to the "internal" affairs of federal associations is wholly unwarranted. It

derives no support from the language or history of HOLA and is flatly contradicted by a large number of prior decisions. Moreover, the proposed restriction is completely at odds with Congress' purpose in investing the Board with plenary regulatory authority. If the Board cannot effectively regulate the lending practices of these institutions, then the survival of the industry, which Congress intended the Board to ensure, is open to serious doubt.

Moreover, *Free* v. *Bland*, *supra*, and *United States* v. *Shimer*, *supra*, do not require that the agency's action be necessary to ensure the survival of regulated entities; instead, it is only necessary that the regulation be a reasonable exercise of statutory authority. It is clear that the Board's due-on-sale regulation satisfies that standard.

C. Two of the mortgages involved in this case contain a standard "law of the jurisdiction" covenant. The Court of Appeal believed that the presence of this covenant "supported" its preemption analysis. That belief is without support because the covenant has no logical bearing on the preemptive effect of the Board's exercise of its statutory authority. Moreover, the court's reading of the covenant conflicts with settled law. It is well established that references to local law in contracts necessarily include all applicable federal law. See, *e.g.*, *Hauenstein* v. *Lynham*, 100 U.S. 483 (1879); *Restatement (Second) of Conflict of Laws* § 4(1), Comment b (1971). Thus, the covenant in question serves to incorporate the Board's regulation; the Board's regulation, in turn, preempts inconsistent state law.

ARGUMENT

THE REGULATION OF THE FEDERAL HOME LOAN BANK BOARD AUTHORIZING DUE-ON-SALE CLAUSES IS A PROPER EXERCISE OF AUTHORITY DELEGATED BY CONGRESS AND THEREFORE PREEMPTS CONFLICTING STATE LAW

Application of the Supremacy Clause of the Constitution through the vehicle of the preemption doctrine often requires a painstaking comparison between state and fed-

eral law to determine whether there are actual or potential inconsistencies in text or purpose that require state law to yield. See, *e.g.*, *Chicago & North Western Transportation Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 319 (1981); *Ray* v. *Atlantic Richfield Co.*, 435 U.S. 151 (1978); *Perez* v. *Campbell*, 402 U.S. 637, 649 (1971); *Florida Lime & Avocado Growers, Inc.* v. *Paul*, 373 U.S. 132, 142 (1963); *Hines* v. *Davidowitz*, 312 U.S. 52, 68 (1941). The inquiry is often complex because preemption is not lightly to be implied and because it is sometimes difficult to discern exactly what Congress intended.

The preemption analysis is far simpler, however, in cases such as this, in which a federal agency adopts an unambiguous regulation under an express grant of authority from Congress. In this situation, the decisions of this Court require a relatively straightforward inquiry into whether the agency has acted to preempt state law and, if so, whether that action was authorized by Congress. See *Free* v. *Bland*, 369 U.S. 663, 668 (1962); *United States* v. *Shimer*, 367 U.S. 374, 377 (1961). See also *United States* v. *Yazell*, 382 U.S. 341, 352 (1966); *Ridgway* v. *Ridgway*, No. 80-1070 (Nov. 10, 1981), slip op. 8, 10-11 (federal regulations have preemptive effect unless "unreasonable, unauthorized, or inconsistent" with federal statute). Applying that analysis to this case, it is clear that the Federal Home Loan Bank Board, exercising the plenary power over federal savings and loan associations granted to it under the Home Owners' Loan Act of 1933, has preempted state law restricting the use of due-on-sale clauses in mortgages written by such associations.

A. The Board's Intention to Preempt State Law with Regard to Due-On-Sale Provisions in Mortgages Written by Federal Savings and Loan Associations is Unambiguous

The Federal Home Loan Bank Board has expressed with clarity its intention that the practices of federal savings and loan associations with regard to due-on-sale clauses are to be governed exclusively by its regulation.

In promulgating 12 C.F.R. 545.8-3(f), the regulation at issue in this case, the Board announced that "it was and is the Board's intent to have * * * due-on-sale practices of Federal associations governed exclusively by Federal law." 41 Fed. Reg. 18287 (1976). Thus, the preemptive intent of the federal administrative agency is unmistakable.[5] Indeed, it was recognized as such by the Court of Appeal (J.S. App. 14a).[6] Accordingly, the principal error in the analysis of the Court of Appeal was its failure to recognize that a properly promulgated regulation of a federal agency stands on the same footing for preemption purposes as an enactment of Congress. *Free* v. *Bland*, *supra*, 369 U.S. at 668; *United States* v. *Shimer*, *supra*, 367 U.S. at 377.[7]

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[5] Appellees assert (Motion to Affirm 2) that the Board's regulation applies to only one of the cases before this Court because the other two cases involve mortgages that were written prior to the 1976 date when the Board's due-on-sale rule went into effect. This effort to avoid the regulation is plainly without merit. The time when the mortgage instrument was negotiated is irrelevant for preemption purposes. The conflict between federal and state law arose when the associations attempted to enforce the due-on-sale clause, which previously had been included in the relevant mortgage contracts by mutual agreement. In all three cases now before the Court, that happened well after the Board's due-on-sale regulation went into effect. Thus, these cases do not involve implied preemption based on an inconsistency between the policy of a federal statute and state law. Rather, they involve express preemption based on a federal regulation that was clearly designed to displace state law, and which was in full effect at the time the preemption issue arose. See *Campbell* v. *Hussey*, 368 U.S. 297, 300 (1961).

[6] The Court of Appeal acknowledged (J.S. App. 15a; emphasis in original) that it "is clear that the *Board* has manifested *its* unqualified intention that the adopted regulations and implementing policy relating to due-on-sale clauses shall occupy a preemptive position over conflicting state law provisions." The court failed to give effect to the federal regulation, however, because "we cannot equate the *Board's* expression of intent with the requisite *congressional* intent * * *."

[7] We of course recognize that the state law involved here deals with real property and therefore is a matter of substantial concern

B. The Board Was Delegated Ample Authority in the HOLA to Regulate the Use by Federal Savings and Loan Associations of Due-On-Sale Clauses

1. *The literal terms of the HOLA show that Congress granted broad regulatory power to the Board*

Since the Board's preemptive intent is not subject to doubt, resolution of the question presented in this case involves only the relatively simple task of ascertaining whether the Board has properly exercised the authority delegated to it by Congress. In light of the language used by Congress in granting the agency broad regulatory authority, as well as the relevant legislative history, subsequent indications of congressional intent, and the virtually unbroken line of judicial decisions recognizing the primacy of the Board's regulatory power over federal associations, there can be no genuine doubt that the Board's regulation is a permissible exercise of its statutory authority.

Reacting in part to the "hodgepodge of savings and loan laws and regulations" existing in the 48 states that had crippled the ability of thrift institutions to provide home-financing,[8] Congress passed the Home Owners' Loan

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to the state. This, however, does not affect the basic preemption analysis. *See Ridgway* v. *Ridgway, supra,* slip op. 7-8. Preemption cases typically involve subjects that the state regards as within its sphere of regulatory concern; otherwise, there would be no conflict between state and federal law. This Court's decisions make clear that federal regulation affecting property within a state is subject to the same constitutional analysis as other forms of regulation. See, *e.g., Hodel* v. *Virginia Surface Mining & Reclamation Association, Inc.,* No. 79-1538 (June 15, 1981), slip op. 24; *California* v. *Southland Royalty Co.,* 436 U.S. 519, 530 (1978); *United States* v. *Shimer, supra,* 367 U.S. at 377. Preemption is not lightly assumed with regard to any state law. But if the intent to preempt is unmistakable and the authority to act is clear, then any inconsistent state law, including property law, must yield.

[8] T. Marvel, *The Federal Home Loan Bank Board* 26 (1969). See also Dunn & Nowinski, *Enforcement of Due-On-Transfer Clauses: An Update,* 16 Real Prop., Prob. & Tr. J. 291, 292 (1981).

Act of 1933. See *Home Owners' Loan Act: Hearings on S. 1317 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 8 (1933). The Act created a federal savings and loan system to be regulated by the Federal Home Loan Bank Board. And in 12 U.S.C. (& Supp. III) 1464(a), Congress broadly empowered the Board, "under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation" of all savings and loan associations within the system.[9] It is difficult to imagine a more expansive grant of authority.

An instructive comparison can be made to the authority granted by Congress to the Comptroller of the Currency over branch banking in the same year that it passed the HOLA. In the 1933 amendments to the National Bank Act, the Comptroller was empowered to regulate the branch banking activities of national banks. That legislation, which passed through the same committees of Congress as the Home Owners' Loan Act, allowed the Comptroller to authorize branch banking only "if such establishment and operation are at the time authorized to State banks by the statute law of the State in question * * *." 12 U.S.C. 36(c)(2). Thus, the Seventy-Third Congress well knew how to limit the authority of a federal agency to conform to state law when it passed the HOLA, and its expansive grant of authority in Section 1464(a) evinces a clear intent that state law is to apply only when *the Board* deems it appropriate.[10]

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[9] In granting this broad regulatory power, Congress did not completely ignore state law. It stated that the Board, in adopting its rules, should "giv[e] primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States." See 12 U.S.C. (& Supp. III) 1464(a). Thus, Congress has provided that rules developed by the states can be applied to federal institutions, but only if the Board so directs as a matter of administrative discretion. See *Central Savings & Loan Association of Chariton* v. *Federal Home Loan Bank Board*, 422 F.2d 504, 506 (8th Cir. 1970).

[10] This Court applied a similar analysis in interpreting a different part of the HOLA in *Hopkins Federal Savings & Loan Association* v. *Cleary*, 296 U.S. 315 (1935). The question in that case was

2. *The legislative history of the HOLA confirms that the Board was granted plenary authority over federal savings and loan associations*

While the legislative history of the HOLA is not extensive, that history clearly shows that Congress intended to grant the Board comprehensive control over federal associations. Thus, in the hearings on the proposed Act, the Chairman of the Bank Board explained that "[t]hese associations will be virtually chartered and the regulations as to how those things will be done are drawn by the board and put into effect." *Home Owners' Loan Act: Hearings on H.R. 4980 Before the House Comm. on Banking and Currency*, 73d Cong., 1st Sess. 23 (1933). See also *id.* at 15.[11] During the brief floor debates on this leg-

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whether Congress intended its rules for conversion of a state association to a federal association to be exclusive, or whether the states could supplement them. This Court held that "Congress had in mind to take possession of the field to the exclusion of other occupants." *Id.* at 333. In so holding, the Court compared the HOLA to the National Banking Act, which made specific reference to state law, and concluded from the comparison in language that: "Congress had no difficulty in finding fit and simple phrases for the expression of its will when power was to be conditioned upon the approval of the States." *Id.* at 334.

[11] An explanation of the Board's power during the Senate hearings is particularly enlightening in the present context. One of the Senators expressed concern that borrowers could take advantage of the provisions of the bill by obtaining financing and then renting the property instead of living there themselves. In response to this concern, the Board's Chairman stated: "That would be a matter of regulation. That could be covered by regulation under the bill." *Home Owners' Loan Act: Hearings on S. 1317 Before a Subcomm. of the Senate Comm. on Banking and Currency*, 73d Cong., 1st Sess. 14 (1933). Asked if the Board had this authority, the Chairman said (*ibid.*):

> If the Federal Home Loan Bank Board should choose to make that kind of a regulation it could put that in. A great many of these local private institutions would put that kind of a clause in their loans. In Ohio, for instance, there are a great many of them that put a clause in that if the borrower

islation, there is no mention of any limitation on the power of the Board to regulate federal associations. Instead, there is the repeated expression of intent to rely on the Board's expert judgment: "[w]e leave such things to the judgment of the board. We give the board great power to administer the act." 77 Cong. Rec. 2481 (1933) (remarks of Rep. Luce). See also *id.* at 2480 (remarks of Rep. Luce); *id.* at 2573-2574 (remarks of Rep. Cellar). The absence of Congressional prescription of the details of the operation of federal savings and loan associations is forceful evidence of Congress' "heavy reliance on the rule-making wisdom of the Federal Home Loan Bank Board." J. Ewalt, *A Business Reborn: The Savings and Loan Story, 1930-1960* 80 (1962). See also *Central Savings & Loan Association of Chariton* v. *Federal Home Loan Bank Board*, 422 F.2d 504, 506 (8th Cir. 1970); *North Arlington National Bank* v. *Kearny Federal Savings & Loan Association*, 187 F.2d 564, 565 (3d Cir.), cert. denied, 342 U.S. 816 (1951) ("[The HOLA] lays down some general rules and prohibitions and leaves details to the Board * * *").

3. *Subsequent congresses have reiterated that the Board has comprehensive authority to regulate federal associations*

The assumption of the Seventy-Third Congress that the Board would exercise broad discretion in regulating the operations of federal savings and loan associations has been reiterated by subsequent congresses. Thus, in 1978, when Congress made provision in the Financial

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moves out of that house and ceases to occupy it as his home they have a right to call that mortgage.

Thus, the Chairman made clear to Congress that the proposed legislation would authorize the Board to regulate mortgage instruments themselves in order to further the general purposes of the Act. This directly contradicts the suggestion of some courts (see pages 18-19, *infra*) that the Board has authority to regulate only the internal affairs of savings and loan associations.

Institutions Regulatory and Interest Rate Control Act of 1978 (Pub. L. No. 95-630, 92 Stat. 3641) to allow mutual savings banks, at their option, to obtain a federal charter from the Board, Senator Brooke emphasized "that we do not intend to interfere with the Bank Board's plenary authority over Federal savings and loan associations, and in this area, Federal law alone would continue to govern." 124 Cong. Rec. 36148 (1978).

Members of the House were equally explicit in describing the Board's plenary authority over federal associations. Thus, one member carefully pointed out that, by allowing state law to control some of the activities of converted mutual savings banks, Congress "[i]n no way, of course, would * * * be interpreted to erode the Bank Board's long-standing plenary authority over Federal savings and loan associations; Federal law alone would continue to govern these institutions in such areas as branching, anti-discrimination, and lending authority." 124 Cong. Rec. 33848 (1978) (remarks of Rep. Hanley); see also *ibid.* (remarks of Rep. St Germain).

Similar views were expressed during the debates on the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132. One member of the House was concerned that expansion of the authority of federal associations over residential real estate loans might be construed to diminish the Board's authority. The Floor Leader who participated in the debate, Rep. St Germain, made clear that the statute by itself would have no such effect. It would expand the powers of the associations "[o]nly if the Federal Home Loan Bank Board permits." He explained that, "[u]nder the Home Owners' Act, the Bank Board has complete authority to determine by regulation the lending practices of Federal associations * * *." 126 Cong. Rec. H2289 (daily ed. Mar. 27, 1980).

Although statements of legislative intent made by later Congresses are not accorded as much weight as expressions of intent by the Congress that originally passed the

legislation, statements such as these, which are completely consistent with earlier indications of legislative intent, have significant supplemental value. *NLRB* v. *Bell Aerospace Co.*, 416 U.S. 267, 275 (1974); *Red Lion Broadcasting Co.* v. *FCC*, 395 U.S. 367, 380-381 (1969); *FHA* v. *Darlington, Inc.*, 358 U.S. 84, 90 (1958). See also *Andrus* v. *Shell Oil Co.*, 446 U.S. 657, 666 & n.8 (1980) (noting that while subsequent legislative statements must be weighed with care, "they should not be rejected out of hand as a source that a court may consider in the search for legislative intent"). In short, the legislative record, beginning in 1933 and continuing to the present day, leaves no room to doubt that Congress intended to give the Board plenary authority to promulgate regulations governing all aspects of the lending practices of federal savings and loan associations.

4. *With near unanimity, the lower courts have recognized the Board's authority to preempt state law relating to federal savings and loan associations*

The clarity of the text of the HOLA and the legislative history explains why the lower courts have recognized, with near unanimity, the plenary authority of the Board to regulate virtually every aspect of the federal savings and loan industry. Over twenty years ago, the United States District Court for the Southern District of California, in describing the scope of the Board's power under the HOLA, adopted a metaphor that has been quoted continuously by other courts ever since. According to the court, the Board's regulations delineate "the powers and operations of every Federal savings and loan association from its cradle to its corporate grave." *California* v. *Coast Federal Savings & Loan Association*, 98 F. Supp. 311, 316 (S.D. Cal. 1951).

In view of this comprehensive delegation of power from Congress, federal and state courts repeatedly have held that the Board's regulations preempt contrary state law. See, *e.g.*, *Conference of Federal Savings & Loan As-*

sociations v. *Stein*, 604 F.2d 1256, 1260 (9th Cir. 1979), aff'd, 445 U.S. 921 (1980); *Meyers* v. *Beverly Hills Federal Savings & Loan Association*, 499 F.2d 1145, 1147 (9th Cir. 1974); *California* v. *Coast Federal Savings & Loan Association*, 98 F. Supp. 311, 318-319 (S.D. Cal. 1951); *Kupiec* v. *Republic Federal Savings & Loan Association*, 512 F.2d 147, 152 (7th Cir. 1975); *First Federal Savings & Loan Association of Boston* v. *Greenwald*, 591 F.2d 417 (1st Cir. 1979); *Glendale Federal Savings & Loan Association* v. *Fox*, 459 F. Supp. 903 (C.D. Cal. 1978); *Conference of Federal Savings & Loan Associations* v. *Stein*, 495 F. Supp. 12 (E.D. Cal. 1979), rev'd on other grounds, No. 79-4818 (9th Cir. Sept. 23, 1981); *Williams* v. *First Federal Savings & Loan Association of Arlington*, 500 F. Supp. 307 (E.D. Va. 1980), aff'd on other grounds, 651 F.2d 910 (4th Cir. 1981); *Dantus* v. *First Federal Savings & Loan Association of Denver*, 502 F. Supp. 658 (D. Colo. 1980), appeal pending; *First Federal Savings & Loan Association of Gadsden County* v. *Peterson*, 516 F. Supp. 732 (N.D. Fla. 1981); *First Federal Savings & Loan Association of Phoenix* v. *Development Management Enterprises, Inc.*, Civ. No. 79-880 (D. Ariz. Apr. 2, 1981); *Rettig* v. *Arlington Heights Federal Savings & Loan Association*, 405 F. Supp. 819, 823 (N.D. Ill. 1975); *City Federal Savings & Loan Association* v. *Crowley*, 393 F. Supp. 644, 655 (E.D. Wis. 1975); *Lyons Savings & Loan Association* v. *Federal Home Loan Bank Board*, 377 F. Supp. 11, 17 (N.D. Ill. 1974); *Elwert* v. *Pacific First Federal Savings & Loan Association*, 138 F. Supp. 395, 399-400 (D. Or. 1956). In addition, every federal court that has considered the issue has decided that the Board's due-on-sale regulation preempts state laws that purport to declare due-on-sale provisions to be an unreasonable restraint on alienation.[12]

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[12] See *Glendale Federal Savings & Loan Association* v. *Fox*, 481 F. Supp. 616 (C.D. Cal. 1979), rev'd on other grounds, No. 79-3573 (9th Cir. Sept. 25, 1981); *Conference of Federal Savings & Loan*

Indeed, this Court previously has recognized the preemptive effect of the Board's regulations. In the *Stein* case, this Court affirmed summarily a decision of the Ninth Circuit which held that Board regulations that prescribe methods for monitoring discriminatory lending practices preempt more intrusive state requirements. *Conference of Federal Savings & Loan Association* v. *Stein*, *supra*, 604 F.2d at 1260, aff'd, 445 U.S. 921 (1980). See also *First Federal Savings & Loan Association of Boston* v. *Massachusetts Tax Commission*, 437 U.S. 255, 258 n.3 (1978).

Ignoring this long line of authority, the Court of Appeal in the present case relied on a distinction (J.S. App. 16a) between the Board's regulatory authority concerning the "internal affairs" of federal associations—over which it concededly has plenary authority—and its authority concerning "external affairs"—over which presumably it has no authority in the face of contrary state law. The distinction also has been accepted in dicta by

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Associations v. *Stein*, 495 F. Supp. 12 (E.D. Cal. 1979), rev'd on other grounds, No. 79-4818 (9th Cir. Sept. 23, 1981); *Bailey* v. *First Federal Savings & Loan Association of Ottawa*, 467 F. Supp. 1139 (C.D. Ill. 1979); *Nalore* v. *San Diego Federal Savings & Loan Association*, No. 77-0660-N (S.D. Cal. July 12, 1979), rev'd on other grounds, No. 79-3481 (9th Cir. Sept. 23, 1981); *Williams* v. *First Federal Savings & Loan Association of Arlington*, 500 F. Supp. 307 (E.D. Va. 1980), aff'd on other grounds, 651 F.2d 910 (4th Cir. 1981); *Great Western Union Federal Savings & Loan Association* v. *Walters*, No. C79-906V (W.D. Wash. June 18, 1980); *Trent Realty Association* v. *First Federal Savings & Loan Association of Philadelphia*, No. 79-1688 (D. N.J. Sept. 16, 1980), rev'd on other grounds, 657 F.2d 29 (3d Cir. 1981); *Collins* v. *First Federal Savings & Loan Association of Walla Walla*, No. C-80-334 (E.D. Wash. May 18, 1981); *First Federal Savings & Loan Association of Gadsden County* v. *Peterson*, 516 F. Supp. 732 (N.D. Fla. 1981); *First Federal Savings & Loan Association of Phoenix* v. *Development Management Enterprises, Inc.*, Civ. No. 79-880 (D. Ariz. Apr. 2, 1981); *Dantus* v. *First Federal Savings & Loan Association of Denver*, 502 F. Supp. 658 (D. Colo. 1980), appeal pending, No. 80-2342 (10th Cir.); *Price* v. *Florida Savings & Loan Association*, No. 79-974 (M.D. Fla. Sept. 1, 1981).

two other courts. See *Holiday Acres No. 3* v. *Midwest Federal Savings & Loan Association*, 308 N.W.2d 471, 478 (Minn. 1981); *Gulf Federal Savings & Loan Association of Jefferson Parish* v. *Federal Home Loan Bank Board*, 651 F.2d 259, 266 (5th Cir. 1981).

None of the three courts that has accepted this distinction has cited any legislative history to support its reasoning.[13] Each has based its analysis solely on the fact that some decisions declaring the Board's regulations to preempt state law have in fact involved internal management activities. See 651 F.2d at 266; 308 N.W.2d at 478; J.S. App. 16a-17a. This analysis, however, ignores the many decisions holding state law to be preempted by Board regulations governing the external affairs of savings and loan associations. Thus, the Wisconsin Supreme Court has held that federal law alone controls the validity of variable rate mortgages. *Kaski* v. *First Federal Savings & Loan Association of Madison*, 72 Wis.2d 132, 133, 240 N.W.2d 367, 369 (1976). Similarly, the Ninth Circuit has held that the validity of a prepayment penalty in a mortgage of a federal association is determined solely by Board regulation, and not state law. *Meyers* v. *Beverly Hills Federal Savings & Loan Association*, 499 F.2d 1145, 1147 (9th Cir. 1974). Finally, the First Circuit has held that the duty of a federal savings and loan association to pay interest on mortgage escrow accounts is a matter regulated by the Board, and that contrary state law is preempted. *First Federal Savings & Loan of Boston* v. *Greenwald*, *supra*, 591 F.2d at 425.

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[13] In addition, it is impossible to find any basis for this distinction in the language of the statute. The Board's authority extends to regulating the "operation" of all federal savings and loan associations. If Congress intended to limit the Board to regulating only the managerial activities of these associations, it would be hard to find a less appropriate choice of words. Under any reasonable interpretation, the "operation" of a savings and loan association includes the issuance of mortgages and the prescription of their terms and conditions. This function lies at the heart of the "operation" of every association. See note 11, *supra*.

These decisions, which broadly construe the Board's authority to regulate mortgage provisions, and which strike down inconsistent standards under state law, are correct and cannot be reconciled with the ruling of the Court of Appeal in this case.[14]

Moreover, an internal-external affairs distinction is completely arbitrary. While it is possible to label a due-on-sale provision as a mere incident of the "external" activities of savings and loan associations, the use of this label is unrelated to economic reality and to the fundamental purposes of the HOLA. The Board's reason for allowing due-on-sale provisions is to protect the economic viability of the thrift industry. These provisions are designed to further goals crucial to the welfare of thrift institutions: (1) they permit lenders to evaluate the credit of each borrower; (2) they permit lenders to increase mortgage portfolio yields during periods of rising interest rates, thereby decreasing the interest rate generally charged at those times for new mortgages; and (3) they facilitate the operation of the secondary mortgage market by shortening the average life of mortgages, thereby increasing secondary market investments and providing additional funds for the residential mortgage market. See *Advisory Opinion of the Federal Home*

[14] The Court of Appeal cites (J.S. App. 11a-12a) a number of cases in which local law has been applied to federal associations and concludes that these decisions support its distinction between internal and external affairs. The court's analysis, however, is misguided. We do not contend that federal savings and loan associations, simply by receiving a federal charter, are immune from the operation of all state laws. Our submission is that Congress clearly gave the Board authority, in regulating federal associations, to oust state law affecting their operations. In the absence of a Board regulation, which was the situation in all of the cases cited by the Court of Appeal, state law would apply unless it interfered with the accomplishment of the purposes of the HOLA. See *Chicago & North Western Transportation Co.* v. *Kalo Brick & Tile Co.*, 450 U.S. 311, 317 (1981); *Perez* v. *Campbell*, 402 U.S. 637, 649 (1971). Here, of course, our preemption analysis rests on a specific regulation, rather than general statutory purpose.

Loan Bank Board, Resolution No. 75-647, in the *Matter of Schott* v. *Mission Federal Savings & Loan Association*, No. Civ-75-366 (C.D. Cal. July 30, 1975). See 41 Fed. Reg. 18287 (1976); App. B, *infra*.

Thus, if the Board is denied the power to regulate the "external" activities of federal associations, and state law is allowed to govern their lending practices, it is no exaggeration to anticipate that, before long, there may be few "internal" activities of federal associations for the Board to regulate at all.[15] As we have demonstrated above (see pages 11-12, *supra*), the Board was created by Congress to ensure the viability of the federal savings and loan industry and thereby guarantee the continued availability of money for home financing. The decision of the Court of Appeal in this case, if allowed to stand, will directly undermine Congress' effort.[16]

The proper approach to determining whether the Board's regulation displaces state law is to ascertain whether the regulation is reasonably related to the "operation" of federal savings and loan associations. See *United States* v. *Shimer*, *supra*, 367 U.S. at 383. See also *Mourning* v. *Family Publications Service, Inc.*, 411 U.S. 356, 369 (1973) ("the validity of a regulation promulgated there-

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[15] Recent assessments of the effect of eliminating due-on-sale clauses in existing mortgages underscore the gravity of the situation. A study by a Task Force of the Federal Home Loan Bank Board estimates that 40% of the total 1981 losses suffered by state-chartered savings and loan associations in California were caused by California's law denying them the contractual right to enforce due-on-sale clauses. (We have lodged copies of the Task Force report with this Court and have served copies on counsel for appellees.) In an industry that is as financially troubled as the federal savings and loan industry, the addition of losses that would result from affirmance of the Court of Appeal in this case would threaten the survival of many federal associations.

[16] "It thus causes the kind of injury to federal interests that the Supremacy Clause forbids. It is not the province of state courts to strike a balance different from the one Congress has struck." *Hisquierdo* v. *Hisquierdo*, 439 U.S. 572, 590 (1979).

under will be sustained so long as it is 'reasonably related to the purposes of the enabling legislation' "). And where, as here, the Board has acted within its expressly delegated authority, the effect of its action is to preempt state law just as surely as if Congress itself had declared due-on-sale clauses to be valid and enforceable.[17]

C. The Presence of a "Law of the Jurisdiction" Covenant in Mortgages in this Case Does Not Alter the Preemptive Effect of the Board's Regulation

The Court of Appeal's opinion also relies upon a "law of the jurisdiction" covenant (Covenant 15) in two of the mortgages here in question as "further support" for its view that the state statute is not preempted by federal law (J.S. App. 19a). "Covenant 15" is the designation

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[17] The Court of Appeal asserted that there is no inherent conflict between state law and the Board's regulation. It observed that the regulation does not compel the enforcement of due-on-sale clauses or compel their inclusion in every mortgage instrument issued by a federal association (J.S. App. 17a-18a).

This line of analysis cannot obscure the conflict: State law forbids precisely what the Board, in the exercise of its administrative discretion, has determined *must* be available as an option for federally chartered associations. State law may not strip away powers and rights guaranteed by federal law. See *Franklin National Bank of Franklin Square* v. *New York*, 347 U.S. 373, 377-378 (1954). Moreover, the Court of Appeal's analysis of the Board's precatory language ignores practical considerations underlying the use of due-on-sale provisions. The Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association require due-on-sale provisions to be included in most mortgages they purchase (see pages 3-4, *supra*). Since the ability to sell a mortgage is important to a savings and loan association, very few mortgages are written without this provision.

Beyond this, the present case is not one involving an implied conflict such as *Florida Lime & Avocado Growers, Inc.* v. *Paul*, *supra*. This case involves express preemption. Thus, whether there is some arguable means of reconciling the operation of the federal and state schemes is beside the point. See *Campbell* v. *Hussey*, 368 U.S. 297, 300 (1961). The only question is whether the act of preemption is a proper exercise of congressionally-delegated power.

given this provision by the Federal Home Loan Mortgage Corporation ("FHLMC") and the Federal National Mortgage Association ("FNMA"), which generally require its insertion as a condition to their purchasing a mortgage for resale in the secondary mortgage market. (See page 3, *supra*.) Covenant 15 provides: "This Deed of Trust shall be governed by the law of the jurisdiction in which the property is located."

Initially, the Court of Appeal wholly failed to explain what relevance the presence of this covenant could have in determining whether the Board has acted to preempt state law and whether that action was permissible under the HOLA. But even assuming that the covenant has some relevance, the court's interpretation is plainly wrong. The obvious intent of the FHLMC and FNMA in including Covenant 15 in mortgages was to provide a uniform choice of law provision for cases where more than one state might acquire jurisdiction over a dispute regarding the proper interpretation of a mortgage. Contrary to the Court of Appeal's suggestion (J.S. App. 19a-20a), Covenant 15 does not purport to elevate conflicting state law above federal law.

Indeed, if such were the intent of this covenant, a poorer choice of words would be hard to imagine. The "law of the jurisdiction" has long been understood to include federal law. As this Court explained in *Hauenstein* v. *Lynham*, 100 U.S. 483, 490 (1879):

> It must always be borne in mind that the Constitution, laws and treaties of the United States are as much a part of the law of every State as its own local laws and Constitution. This is a fundamental principle in our system of complex national polity.

See also *Public Service Commission of Utah* v. *Wycoff Co.*, 344 U.S. 237 (1952); *Mondou* v. *New York, N.H. & H.R.R.*, 223 U.S. 1, 57 (1912); *Testa* v. *Katt*, 330 U.S. 386, 390-391 (1947).

General principles of conflict of law also recognize that reference to the law of a particular jurisdiction includes

both local and federal law. "Local law" is defined as follows by the *Restatement (Second) of Conflict of Laws* § 4(1), Comment b (1971):

> [T]he local law of a state is the body of standards, principles and rules, exclusive of its rules of Conflict of Laws, which the courts of that state apply in the decision of controversies brought before them.[18]

Comment b further explains that

> [t]he "local law" of a State of the United States includes such rules of federal law as are binding upon it.

Thus, when the contracting parties here involved used the phrase "law of the jurisdiction," they quite obviously intended to refer to California law *and* applicable federal law. And since the Board's due-on-sale regulation is fully applicable and preempts contrary California law, the law of the jurisdiction in California for federal savings and loan associations includes the Board's preemptive regulation.

The FHLMC has consistently interpreted Uniform Covenant 15 to include federal law within the phrase "law of the jurisdiction." In an opinion letter dated May 24, 1978 (App. A, *infra*), the FHLMC's General Counsel stated that Uniform Covenant 15 was, from its inception, intended not to oust federal law, but to provide a rule of choice among competing state laws in those situations where, by express provision of the uniform instruments, state law governs.[19] That opinion is hardly sur-

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[18] The "law" of a state is that state's local law, together with its rules of Conflict of Laws. *Restatement (Second) of Conflict of Laws* § 4(2) (1971).

[19] The opinion of the FHLMC, which drafted Uniform Covenant 15 in furtherance of a specific Congressional mandate, should be accorded substantial weight. See *E.I. du Pont de Nemours & Co.* v. *Collins*, 432 U.S. 46, 56-57 (1977); *United States* v. *Larionoff*, 431 U.S. 864, 872 (1977).

prising. If Uniform Covenant 15 displaced applicable federal law, it would subject FHLMC's nationwide mortgage purchase program to the vagaries of inconsistent state law and frustrate its legislative mission to create a uniform secondary mortgage market.[20] See generally Randolph, *The FNMA/FHLMC Uniform Home Improvement Loan Instruments: A Commentary and Critique*, 16 Real Prop., Prob. & Tr. J. 546, 589-590 (1981).

The Court of Appeal reached a contrary conclusion largely in reliance on the following sentence found in Uniform Covenant 15:

> In the event that any provision or clause of this Deed of Trust or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Deed of Trust or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Deed of Trust and the Note are declared to be severable.

This sentence is nothing more nor less than a standard severability clause found in numerous contracts. It does not purport to be—and cannot be reasonably construed as—a choice of law provision. The sentence merely ensures that the invalidity of any one provision, under any

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[20] The only federal court to interpret the effect of Uniform Covenant 15 has flatly rejected the reasoning of the Court of Appeal in this case. The court held:

> [I]t is the opinion of this Court that the reference to "the law of the jurisdiction in which the Property is located" in ¶ 15, means the law of the state in which the property is located as preempted or supplemented by federal law. Support for this reading can be derived from the fact that ¶ 15 is set forth in the form deed of trust under the section entitled "Uniform Covenants." It is clear that this section of the form was intended for national use. Given this reading it is clear that defendants' argument that ¶ 15 renders ¶ 17 unenforceable is not well taken.

Great Western Union Federal Savings & Loan Association v. *Walters*, No. C79-906V, at 3-4 (W.D. Wash. June 18, 1980).

applicable law, will not destroy the entire contract. The severability clause in no way alters the plain meaning of the "law of the jurisdiction" language appearing in the prior sentence.[21]

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[21] Appellees suggested at the jurisdictional stage (Motion to Affirm 17-19) that the Court of Appeal's analysis of Covenant 15 affords an adequate and independent state law ground that defeats this Court's jurisdiction to review the federal preemption issue in two of the cases. Under that theory, Covenant 15 is deemed to be a contractual waiver by appellants of rights granted by the Board's regulation. This Court correctly rejected that assertion when it noted probable jurisdiction in this case. In the first place, it is clear from the decision of the Court of Appeal that it based its ruling on federal preemption grounds, not on state law contract grounds. The court stated (J.S. App. 8a) that "[t]he pivotal question to be decided is whether the federal regulation overrides state law embodied in California Civil Code section 711, as interpreted in *Wellenkamp*." The court described its holding with equal clarity (*id.* at 4a): "We have concluded that application of the state law has not been federally preempted and * * * the *Wellenkamp* rule does preclude exercise of the due-on-sale clause in the deed of trust * * *." In these circumstances, this Court's jurisdiction is plain. See R. Stern & E. Gressman, *Supreme Court Practice* 238 (5th ed. 1978) ("if the state court explicitly bases its decision solely upon a determination of the federal question, the Supreme Court will review the case even though the state court, consistently with the record, might have based its decision upon an adequate state ground"). Beyond this, any attempt to avoid the clear mandate of the Board's regulation by reliance on a contract theory would raise a question of federal law, not state law. Federal law would govern because the purported "waiver" would relate to federally guaranteed rights, and because Covenant 15 is an integral part of a federally developed mortgage instrument designed to standardize lending practices on a nationwide basis, as the Court of Appeal recognized (J.S. App. 19a, 23a). In this situation, federal law serves to " 'protect uniquely federal interests' " (*Texas Industries, Inc.* v. *Radcliff Materials, Inc.*, No. 79-1144 (May 26, 1981), slip op. 10. See *South Buffalo R.R.* v. *Ahern*, 344 U.S. 367, 372-373 (1953); *Dice* v. *Akron, C. & Y. R.R.*, 342 U.S. 359, 361-362 (1952); *Garrett* v. *Moore-McCormack Co.*, 317 U.S. 239, 244 (1942); *Farmers Elevator Mutual Insurance Co.* v. *Jewett*, 394 F.2d 896, 899 (10th Cir. 1968). For this additional reason, state law could not provide an adequate and independent ground for supporting the ruling below. See Stern & Gressman, *supra*, at 238-239.

CONCLUSION

The judgment of the Court of Appeal should be reversed.

Respectfully submitted.

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FEBRUARY 1982

Appendix

APPENDIX A

HENRY L. JUDY
Vice President
General Counsel

THE MORTGAGE CORPORATION

May 24, 1978

Anne P. Jones, Esquire
General Counsel
Federal Home Loan Bank Board
1700 G Street, NW
Washington, DC 20552

Dear Ms. Jones:

This letter is in response to your request for my opinion on the meaning and effect of the choice of law provision contained in Uniform Covenant 15 of the FNMA/FHLMC Single-Family Mortgage Instruments, particularly as that provision affects the interrelationship of federal and state law. Uniform Covenant 15, which is found in each state home mortgage instrument, provides:

> "This form of mortgage combines uniform covenants for national use and non-uniform covenants with limited variations by jurisdiction to constitute a uniform security instrument covering real property. This Mortgage shall be governed by the law of the jurisdiction in which the Property is located. In the event that any provision or clause of this Mortgage or the Note conflicts with applicable law, such conflict shall not affect other provisions of this Mortgage or the Note which can be given effect without the conflicting provision, and to this end the provisions of the Mortgage and the Note are declared to be severable."

This letter will analyze the meaning of Uniform Covenant 15 in terms of the history of its drafting, the effect of

federal supremacy and the intent of the parties reflected by the mortgage.

The Drafting History:

Initially, I believe a brief explanation of the history of the uniform mortgage instruments would be helpful. When the Emergency Home Finance Act of 1970, 12 U.S.C. § 1451, created The Mortgage Corporation ("FHLMC") and authorized the Federal National Mortgage Association ("FNMA") to purchase conventional home mortgages, FHLMC and FNMA undertook jointly to prepare their own conventional mortgage documents. The Congressional hearings which led to the federal sponsorship of a secondary market for conventional mortgages had emphasized the need to standardize the terms of home mortgages in order to facilitate their acceptability as investments in a national market. Accordingly, the two Corporations endeavored to prepare forms that would provide a maximum degree of national uniformity.

We felt our forms would benefit from a standard choice of law provision to help reach our goal of maximum substantive uniformity. The choice of law sentence was included in Uniform Covenant 15 to state a rules of choice for potentially competing state laws; issues of this type were anticipated, and these could not always be resolved by drafting. The choice of law sentence in Uniform Covenant 15 of the mortgage was not intended to state a choice of state as opposed to federal law.

In fact, we understood that federal law was generally applicable to a loan originated on the FNMA/FHLMC forms if the lender was a federally chartered institution and that this was mandated by the federal law itself. Pursuant to the Congressionally delegated authority to "make policy", the Federal Home Loan Bank Board has promulgated "comprehensive" regulations which, the courts have uniformly and consistently held, govern every aspect of the operations of every federal savings and

loan association from its birth to its death. *People* v. *Coast Federal Savings & Loan Association, supra*, 98 F. Supp. 311 (S.D. Cal. 1951); *Kupiec* v. *Republic Federal Savings & Loan Association*, 512, F.2d 147, 150 (7th Cir. 1975). As you know, the rationale of the *Coast Federal* case was adopted by the Ninth circuit in *Meyers* v. *Beverly Hills Federal Savings & Loan Association*, 499 F.2d 1145 (9th Cir. 1974). At issue in *Meyers* was whether a Board regulation on the terms of mortgage loans made by federal associations so occupied the field as to exempt federal associations in California from state law dealing with prepayment penalties. The Ninth Circuit held flatly and unequivocally that in an area regulated by the Board "federal law preempts the field" so that "any California law in the area is inapplicable to federal savings and loan associations operating within California" (499 F.2d at 1147).

However, even lenders governed by federal law may be concerned about specifying a choice between potentially applicable state laws because governing federal law may require compliance with state rules. An example of the need to choose among competing state laws can be seen in a current example involving home mortgage transactions which arguably are subject to the law of two states. Today certain Maryland lenders, even those which are federally chartered, lending to Virginia residents on Virginia property could be said to be required to pay interest on a mortgage escrow account maintained in connection with that loan because of a Maryland statute requiring interest to be paid on escrow accounts. State lenders are directly subject to this law; federally chartered associations must comply with this particular state law pursuant to FHLBB Reg. § 545.6-11(c). (This requires federally chartered associations to pay interest on escrow accounts if state chartered lenders must, although not necessarily at the rate required by state law.) I understand that Maryland lenders, state and federal,

using the FNMA/FHLMC Mortgage have taken the position that Maryland law does not apply to such loans, in part because of the Uniform Covenant 15 choice of law provision.

Another example of the need for Uniform Covenant 15 in order to choose among competing state laws arises under the Uniform Probate Code. The general common law rules is that the rights of survivors in a decedent's real property situatied [*sic*] in a state other than the state of the decedent's domicile are to be determined in accordance with the law of the jurisdiction in which the realty is situated. However, the Uniform Probate Code overrules this common law principle and provides that the law of the decedent's domicile governs a surviving spouse's rights in real property located in another state. The effect of this may be that a waiver of dower, which would be enforceable in the jurisdiction in which the property is located and the mortgage is taken, would be unenforceable because of the application of the law of the decedent's domiciliary state. Uniform Covenant 15's choice of law provision should preserve the enforceability of the dower waiver by directing the domiciliary state court to apply the law of the state in which the property is located and thereby uphold the waiver.

Lenders, consumers, and their lawyers who commented in 1970 and 1971 on the exposure draft version of the mortgage instruments circulated nationally by FNMA and FHLMC understood that the purpose of Uniform Covenant 15 was to choose among competing state laws. Most persons commenting on the substance of the choice of law provision in Uniform Covenant 15 focused on the fact that the provision referred only to the "Mortgage" and not to both the "Mortgage" and the "Note". None of the commentators suggested that the clause in any way went beyond stating a choice between competing state laws.

Federal Supremacy:

I would like to make some observations about the effect of Uniform Covenant 15 with regard to the litigation involving the enforceability of due-on-sale clauses under the state law and the federal preemption issue. State law necessarily includes federal law to the extent to which the federal Constitution provides for federal supremacy and the federal government has acted within its authority. Thus, a provision which states that the law governing the contract is "the law of the jurisdiction in which the property is located" does not exclude federal law. Federal law necessarily is a part of the law of that jurisdiction. For this reason, a choice of law provision such as Uniform Covenant 15 provides no basis to find an intent on the part of the contracting parties to choose between state and federal law or to disavow the application of any federal law or regulation that might apply to that contract.

The Intent of the Parties:

I believe that consideration of the parties' contractual intent is important because of the substance of the Board's regulation on "due-on-sale" clauses such as Uniform Covenant 17 of the FNMA/FHLMC Mortgage. As you know, the Federal Home Loan Bank Board's due-on-sale regulation does not require federally chartered savings and loan associations to obtain the right to accelerate on sale. Rather, the regulation states that if a federal association does contract for this right, the contract provision shall be enforceable. Therefore, the question that would arise if the choice of law provision in Uniform Covenant 15 were deemed relevant in a dispute over the enforceability of Uniform Covenant 17 would be whether the parties to the mortgage intended to disavow the application of the sanctioning federal regulation. That question must be answered from the specifics on the contract.

For the reason I have just suggested, I do not believe it is possible to infer such an intent on the basis of the

choice of law sentence in Covenant 15. To the contrary, it seems to me that the sentence states no choice at all as between federal and state law. Therefore, if there is a question as to whether the parties contracted for a due-on-sale provision, other provisions of the contract must be examined. Such an examination reveals that the FNMA/FHLMC Mortgage contains an express provision on this point which establishes the parties' intent to create an enforceable due-on-sale provision. This is reflected in Uniform Covenant 17 (which, in the case of California, is repeated in the Note as well).

It is a basic rule of contract interpretation that a specific provision will control over a more general provision. *Restatement, Contracts*, § 236(c); *Corbin on Contracts* One Volume Edition §§ 545-554; 17 Am. Jur. 2d *Contracts* § 270. This concept is reflected in the *Restatement Second, Conflict of Laws* by the rule that a choice of law provision will not be applied to invalidate a term of contract which would be valid under other applicable law. *Restatement Second, Conflict of Laws* § 187, Comment (e); accord; *Kossick* v. *United Fruit Co.*, 365 U.S. 731, 741 (1961); *Pritchard* v. *Norton*, 106 U.S. 124, 137 (1882). Thus, given the express contractual provision of Uniform Covenant 17, conferring the right to accelerate on sale, it is most implausible to argue that the parties did not intend this provision to be an enforceable term of the contract.

Conclusion:

Based on the foregoing, it is my conclusion that neither the drafting history of the FNMA/FHLMC forms, the relationship of federal and state law nor the intent of the parties to the loan can reasonably be understood to state a choice between federal and state law. Federal law preempts state law for federally chartered associations unless state law is chosen by the federal rule, and nothing in Uniform Covenant 15 changes this. Moreover, a court

seeking to give effect to the choice of law sentence must consider applicable federal law as part of the law of the jurisdiction in which the mortgaged property is located. If, for example, federal law expressly gives the parties to the mortgage an option to choose a particular term of the mortgage, state law on the enforceability of that term provision is, for loans governed by federal law, immaterial. The only question would be whether the parties had exercised their option under federal law. That question must be answered by the specifics of the contract, *e.g.* whether their contract contains the provision and whether the provision is in a form which complies with the federal regulations. If these tests are met, such an express term of the contract should not be invalidated on the basis of an implication sought to be drawn from a general provision of the contract.

If I can provide further information or assistance to you, I will be pleased to do so.

Sincerely,

/s/ Henry L. Judy
HENRY L. JUDY

HLJ:kms

cc: James E. Murray,
Senior Vice President and General Counsel,
Federal National Mortgage Association

APPENDIX B

REPORT OF THE TASK FORCE ON DUE-ON-SALE*

January 29, 1982

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* We are here reproducing for the Court's convenience the summary of an unpublished report on due-on-sale clauses issued by a Task Force of the Federal Home Loan Bank Board. Copies of the entire report have been lodged with the Clerk of the Court and served on the parties.

SUMMARY

The due-on-sale clause has been a traditional element of the conventional mortgage loan contract for many years. It permits the mortgage issuer to recall the mortgage loan when the property collateralizing the loan is sold. Recently, there have been successful challenges to the enforcement of the clause in existing mortgage contracts and prohibition of the provision in new contracts. There are now 18 states in which due-on-sale enforcement is restricted and many others in which its enforcement is being challenged in court or the legislature.

Although there is a continuing controversy over the legal issues involved, the economic implication is clear. Prohibition of due-on-sale provides no net social benefit. It provides no new housing, upgrades no existing dwelling, and provides no home improvement. The immediate effect of a prohibition is a redistribution of wealth to those few individuals who have a mortgage loan of a certain type. The costs of this windfall to the consumer are substantial. These costs take the form of:

- Reduced availability of long-term fixed-rate mortgages,
- Higher mortgage rates which make housing less affordable,
- Encouragement of unsound borrowing practices which intensify default risk, and
- Uneven distribution of windfalls.

In addition to the costs to the consumer, the elimination of due-on-sale clauses in existing mortgages will have a devastating effect on the thrift industry, already plagued by economic problems. In fact, existing due-on-sale restrictions in California are already contributing substantially to losses incurred by state-chartered associations there. Estimates of the loss place it at 40 percent of the total 1981 loss by these institutions.

Current court cases on extending due-on-sale restrictions to federally chartered associations have severe implications. Losses for federally chartered associations in California are projected to reach $15 to $20 million annually after two years. Furthermore, this extension of due-on-sale restrictions could easily spread to all federally chartered associations and to all states. Projections of the earnings losses two years after a nationwide restriction on due-on-sale clauses run from $600 to $800 million for federal associations and from $1 to $1.3 billion for all federal and state associations.

Earnings losses from due-on-sale restrictions will further hurt an already weakened industry, forcing more associations into insolvency. Earnings projections for the next two years show that the number of associations encountering net worth deficiencies increases by 17 percent if clauses are restricted nationally.

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